

**THE TEXT IS FLY
WITHIN THE BOOK
ONLY**

Alfred J. Blasco

PROCEEDINGS
of
Departmental
Conferences
held at
Denver Convention
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DEPARTMENTAL CONFERENCE LEADERS AT DENVER

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FOREWORD

Dear Authors:

As we pass along to you now this book which is yours, we do so in the hope that each of you may find his own article just as sound, just as original, just as scintillating, as when it floated magically about in his brain, uncommitted to paper.

It will be amusing to renew acquaintance with it, decked out in its stiff panoply of print, drawn up in line with eighty-two other articles, and to see how bravely it holds its place in the ranks. Or, to change the figure, it will be rather like regarding your own offspring entered in a baby show—your feeling, a mixture of pride and sheepish modesty.

As you read your speech, and the other fellow's, beautiful Denver will rise before your mind's eye—the snow-capped mountains, the restfully low buildings, the immaculate streets. You will recall interesting days, filled to the brim with "shop" of the most stimulating kind; you will remember jolly social evenings, and friends, both old and new; and you will take once more in imagination the magical motor trip to Echo Lake.

May your own book be to you a worthy record of a June week well spent.

THE EDITOR

Dear Readers:

Through many a winter's evening we hope this chubby volume will prove a companion worth having.

Perhaps its chief recommendation to you as bank men and women is not the fact that it treats of your specialty: you would inform yourselves broadly on that subject in any case. But you are far less likely to gain unaided that broad survey over the entire work of your organization which will give you understanding and sympathy for your fellow workers and at the same time put you in line for promotion into higher fields. This it is which we hope our volume will do for you.

If you attended the Convention yourself and were one of the fellows who held forth at length during the discussions, you will get a "talking picture" of yourself that may surprise you by its eloquence.

If you were not a delegate, still, by digesting all the articles in this book, you will be able to converse learnedly with your friends on Budgetary Control, Interior Clearings, and other abstruse subjects.

In any case, we commit this volume into your hands with the sincere hope that you will like it.

THE EDITOR

The Departmental Conferences

The departmental conferences were held at the Brown Palace Hotel, the Hotel Cosmopolitan, and the Shirley-Savoy Hotel, on Tuesday, June 17, from 12:30 p.m. to 4:30 p. m., on Wednesday, June 18, from 8:00 a.m. to 11:45 a.m., and on Thursday, June 19, from 12:30 p.m. to 4:30 p.m. The conferences were under the direction of the Chairman of the Departmental Conference Committee, Nelson M. McKernan, of the Irving Trust Company, New York. The leaders of these conferences were as follows:

AUDITS AND ACCOUNTING, led by Elmer W. Pollock, Assistant Vice President and Comptroller of The First National Bank and Trust Company, Tulsa, Oklahoma.

BANK ADMINISTRATION, led by Clark G. Mitchell, Vice President of The Denver National Bank, Denver, Colorado, assisted by M. H. Malott, President of the Citizens Bank of Abilene, Abilene, Kansas.

BUSINESS DEVELOPMENT AND ADVERTISING, led by A. B. Culbertson, Trust Officer of The First National Bank of Fort Worth, Fort Worth, Texas, assisted by R. S. Racey, Assistant Cashier of The Chase National Bank of the City of New York, New York.

CREDITS, led by William Tonks, Vice President and Credit Manager of The Union Trust Company, Cleveland, Ohio, assisted by Alexander Wall, Secretary-Treasurer of the Robert Morris Associates, Lansdowne, Pennsylvania.

DEPOSIT FUNCTIONS, led by Russell G. Smith, Vice President of the Bank of Italy National Trust & Savings Association, San Francisco, California, assisted by H. R. Smith, Assistant Cashier of the Bank of Italy National Trust & Savings Association, San Francisco, California.

INVESTMENT AND INVESTMENT BANKING, led by Ivan D. Carson, Assistant Sales and Advertising Manager of Greenebaum Sons Investment Company, Chicago, Illinois.

SAVINGS BANKING, led by Henry R. Kinsey, Vice President of the Williamsburgh Savings Bank, Brooklyn, New York, assisted by Lindley A. Bond, Assistant Treasurer of the Home Savings Bank, Boston, Massachusetts.

TRUST FUNCTIONS, led by Leroy McWhinney, Vice President of The International Trust Company, Denver, Colorado, assisted by William W. Jacka, Assistant Vice President of the Bank of Italy National Trust & Savings Association, San Jose, California.

Audits
and
Accounting

Auditing Department Organization and Manual of Procedure

By WILLIAM C. TOMPKINS*

AUDITOR OF THE FIRST NATIONAL BANK IN ST. LOUIS, ST. LOUIS, MISSOURI

Address before the Denver Departmental Conference

Mr. Tompkins describes the attitude of the ideal bank auditor as one of "critical disinterestedness." He must be "in" the bank and yet not "of" it, and, like the cat in Kipling's story, he must, by the nature of his work, "walk by himself."

At no time must his task become mechanical; he must strive against settling into a comfortable routine too easily predictable by the bank's employees. For this reason, a judicious combination of the continuous audit and the spot audit gives the best results.

If the auditor is to function effectively, he must have "full authority to check any and all of the transactions, of any kind whatsoever, of any department, individual, or official of the institution, at any time he sees fit, and without interference by any one." But to sustain this unusual degree of supervisory authority without giving offense, he must be a man of consummate tact. This is a lofty standard to set for any human being, but Mr. Tompkins, by his detailed explanation, makes it sound both practicable and attractive.

IN considering the organization problem of a bank auditing department, it is essential to bear in mind the underlying purpose of such a department. Generally speaking, in the larger institutions, the auditing division of a bank has four essential functions. These consist of

1. Installation of an adequate system of accounting
2. Verification of books, accounts, and records
3. Coordination of the accounting operations of the various departments within the bank
4. If the bank has branches, branch bank accounting.

Having these functions in mind, the

problem of the bank auditor is that of so organizing his department that each of these activities will be performed with the highest degree of efficiency.

EVOLUTION OF THE AUDITING DEPARTMENT

When auditing departments were first established, the main idea was to develop an adequate and comprehensive system of accounting so as to make certain that all the records of the bank would reveal its true status. Consequently, at first, the function of the auditing department was not very specifically defined.

* Because of the inability of Mr. Tompkins to attend this conference, his paper was read by Robert D. Kerr, of the credit department of the same bank.

While it was charged with the duty of installing an adequate system of accounting, and looking after the proper verification of books, accounts, and reports, it was given little other authority. Its essential duty was considered to be really limited to a more or less mechanical verification of the books of the bank, with a view to securing a proper conservation of assets.

Later experience, however, demonstrated that it was not feasible to consider auditing as being merely the mechanical verification of accounts and records at stated intervals. It was found that the auditing department, to function properly, must not only develop a continuous audit of certain departments, but must also have some degree of supervision over other departments. And, as the realization of this fact grew, it became patent that the auditing department must co-ordinate the accounting operations of the various departments within the bank. Unfortunately, this latter function is not generally so fully appreciated as it should be.

For the auditing department to supervise properly the conservation of assets and the verification of accounts, it is essential that it be given also general supervision with respect to the accounting system of each department, in order to bring about the proper coordination between the various departments. If the auditing department is not given actual supervision in this respect, it should at least be consulted by the various department heads, to secure uniformity of method and to eliminate the possibility of useless duplication of effort. To use the military term, the auditing department should act as the *liaison* division of the bank in connection

with all internal operating problems. This supervision or counsel should develop a thorough internal check on departmental operations, and, in addition, should sufficiently control the organization of departmental accounts and reports so that these records and reports will reveal the greatest amount of information to the executives and thereby provide them with a sound basis for determining policies.

It is not the purpose of this discussion to consider the problem of branch bank accounting, since this is a phase of accounting activity that is as yet of only limited interest in the United States. That item of our original fourfold division of the subject may, accordingly, be dismissed at once.

REGULAR PROCEDURE

Auditing department procedure divides itself into

1. The daily audit or check
2. The reconciling of accounts
3. The general audit.

In considering each of these activities, it should be borne in mind that because of the effectiveness of automatic checks and controls, it is not necessary to subject the operations of all departments to a daily audit. The reason for this is that the system of proving and reporting the work of many departments acts as an effective check upon inaccuracies. For example, in the receiving tellers' department the daily proof shows that the total of the deposit slips, assorted according to customers' ledgers, equals the receipts of cash and cash items, assorted according to the disposition made of them. The receiving teller closes his work each day, and those departments which re-

ceive work from him must verify the accuracy of his sendings in preparing their own proofs.

Departmental charges should be limited and controlled, so that each department allowed to charge or credit another is automatically checked each day by tellers, and departments not offsetting will throw out the cash balance sheet.

CONTINUOUS AUDIT AND SPOT AUDIT

The continuous audit is most useful whenever an operation is such that it is not automatically checked by more or less parallel work with another department. Where such a situation exists, the daily audit should be used. This consists of reviewing and checking actual transactions after they have passed through the operating department. These daily audits are usually of two kinds: the "continuous audit" and the "spot audit." In the case of such transactions as the issuance of credit instruments, travelers' checks, certificates of deposit, and cashiers' checks, the receiving of negotiable funds not accounted for on cash proofs, the making of adjustments for customers, the computing of earnings, and so forth, close supervision is required at all times, regardless of the efficiency of the department that handles them. Accordingly, all transactions of this sort should be checked immediately by the accounting department.

The spot audit, on the other hand, is really nothing more than a temporary form of the daily audit and is used for practical purposes in place of the continuous audit wherever possible. In the use of the spot audit, the auditors make their appearance

in a department at irregular intervals and check all the work passing through a specific process for a few days, thus securing a good idea of how the work is being done.

The continuous audit, while it has many desirable features, aside from the cost involved, has certain inherent weaknesses that should be realized. If work is constantly being checked, the clerks tend to relax their alertness. Too close association between auditing clerks and those of other departments is not desirable; it frequently causes oversights which should not occur.

The spot audit, on the other hand, has a certain degree of effectiveness in a way of increasing the efficiency of operating units, because of uncertainty as to the time when it will occur. Expectancy of a possible audit sharpens the wits.

Another practical matter to be considered in maintaining the efficiency of the audit staff itself is that a certain degree of isolation from other departments of the bank should exist. To a large extent this purpose can be accomplished by transferring the auditors from one type of work to another at frequent intervals. In this way, the work of each member of the auditing department is checked, and at the same time too close a relationship does not spring up between members of the auditing staff and other departments.

MAINTAINING AN EFFECTIVE CHECK

By means of the periodical reconciling of accounts, an effective check over the accuracy of ledger accounts and the lawful reserve account is provided. In addition to the continuous

audit and the reconciling of accounts, the auditing department is charged with the making of the general audit. This, in many respects, is similar to the audits made by outside agencies. Where the continuous and spot audits submit some specific banking process to detailed examination, the general audit consists of a comprehensive examination of the records covering the operations of the various departments over a considerable period of time. In the making of the general audit, the movement from one department to another should be guarded with secrecy, and inspection should be made with the same critical attitude as would be maintained by good bank examiners. This general audit, of course, includes all departments, regardless of whether or not they are subjected to a continuous audit. It is, however, restricted largely to those phases of the bank's work which have to do with the handling of money and securities.

Fundamentally, of course, it is the duty of the auditing department to see that the assets of the bank are kept intact at all times, and that proper reports, which reflect the true present condition of the bank, are made to the various officers and to the board of directors. In order to accomplish this purpose, there are several important practical aspects which it might be well to stress.

All tellers should be checked regularly, and at least once each month (and possibly oftener) the procedure of this check or audit should be varied. Sometimes the check should be made in the evening and sometimes at the beginning of the day's work. In checking the tellers' work, not only should the cash be counted, but items handled during the day should be

scrutinized and any unusual transactions run down. If, in the opinion of the person making the audit, transactions appear to be irregular, the work of several previous days should be gone over. At no time should tellers be allowed to hold cash items, unless such items carry the approval of an officer having the authority to give it, together with the added approval of the auditor. Cash items should not be held on the approval of only one officer; if they are referred to the auditor, all items that do not meet with his approval can be immediately taken care of.

In our institution, no teller except the note teller is allowed to hold cash items, and this teller's items are under constant supervision. This arrangement facilitates the work, as inquiries by telephone or other mediums can be readily answered.

The work of tellers and bookkeepers should be carefully separated and segregated, and the same men should not be called upon to work in both departments.

The bookkeeping department should be handled in such a way as to allow the delivery of the statement and canceled vouchers to customers by representatives of the auditor's department. Bookkeepers should be checked at intervals and not kept on the same set of books for too long a period. After items have been entered, it is wise to transfer these from the bookkeeping department to the auditor's office, where they are filed by the auditor's assistants. The staff of the auditing department, together with such assistants as are needed, should check all statements and prepare them for delivery to the customers.

If the bank has a savings depart-

ment, a careful audit should likewise be made at regular intervals of all transactions in that department. If the size of the bank warrants, tellers and bookkeepers in the savings department should be separate and distinct, and employees should not be used in both positions.

It is well to have such assets of the bank as are in the custody of an officer placed under the joint control of this officer and the auditor, if such a course is practicable. That is, all departments that handle bonds, securities, or collateral of any kind, either for the bank's own account or for safekeeping for the accounts of customers, and all dormant or inactive accounts, should, so far as is possible without interfering with the efficiency of the work, be under joint control of the auditing department.

All other departments should also be checked, and it is well for the staff of the auditing department to include men trained in the work of the various departments of the bank. For example, auditing the transit department will be expedited if the person making the check is familiar with the work and can take charge of paying off all outstanding items under a certain date and proving their correctness.

THE MORAL EFFECT OF CHECKING

It should be realized that while, on the one hand, every effort is being made to develop systems that will safeguard the assets of the institution and prevent dishonest transactions, on the other hand, there are persons continually studying these systems so as to circumvent their purpose. Experience has shown that in the audit of any department, the moral effect

of continuous and periodical check does more to prevent defalcation, in all probability, than does the actual check itself. Work is so handled as to keep the individual employee in doubt as to the particular procedure that the auditing department is likely to pursue at any given time. It necessarily follows that, in handling the work of such a department, the man in charge should be able to adjust the system in many different ways without loss of efficiency or fundamental purpose, and should use discretion in choice of procedure. In other words, a system must be developed, but it must be a flexible one, capable of being changed to meet the needs that arise.

In final analysis, it should be realized that for any auditing department to function properly, it is incumbent upon the board of directors of the institution to give to the auditor full authority to check any and all of the transactions, of any kind whatsoever, of any department, individual, or official of the institution, at any time he sees fit, and without interference by any one. It is also essential that the auditor in charge be a man possessed of unusual tact, and that he be endowed with common sense in a high degree. Where changes are necessary, he must be able to bring them about without striking a jarring note in the organization. This means that he must not only be a diplomat, but that he must be practical, studying the problems of the bank from the broadest possible standpoint, and not from the standpoint of any one department or individual. His experience with various accounting systems and problems should fit him peculiarly well for general supervisory duties. In order to perform all of these duties

and functions properly, the auditor must occupy what has come to be a position in the modern bank different from that of other officers, yet carrying authority commensurate with his responsibility. While he must at all times work with the various executives, his responsibility should be directly to the board of directors through the president or the chairman of the board. His attitude should be one of critical disinterestedness.

Discussion

GLENN E. BRUMBAUGH (St. Joseph Stock Yards Bank, St. Joseph, Missouri): If an institution is of sufficient size to have a committee in charge of the personnel, should the auditor be a member of said committee?

THE CHAIRMAN: That question has been asked in previous years at these same conferences and almost without exception we have arrived at the conclusion that the auditor should be a member of the committee or should at least be consulted on the employment of personnel within the institution. Does any one have a contrary opinion to that?

O. W. KOEBER (Mid City Trust & Savings Bank, Chicago): In the handling of real estate loans, is it better to have all papers pertaining to the loan held with the notes by the discount department?

WILLIAM H. SIMMONS (First City Trust & Savings Bank, Akron): No. In auditing these papers I am looking at them from an auditor's standpoint. If the papers are kept in the note file under discount bonds or the mortgage loan department, it affords an opportunity for certain papers to be removed. These

papers, consisting of the appraisal, title report, insurance, and so forth, should be kept in one file. We use a little envelope, and if all those papers are in there and kept under joint control by the auditor, they cannot be removed. For instance, suppose that an officer wanted to put through a loan and not have it recorded in the minutes, not passed by the executive committee. He could remove that appraisal from the loan discount department, and in checking it, about the only thing the auditor could do is to report it on his list as missing. In going through this file kept in the vault under joint control, you know when you accept these papers that they have all got to be there, the account for the appraisal report, title report, and adequate amount of insurance, and so forth, and if any papers are missing after that, either upon examination by the state department or national examiners or your own examination by the directors, you will know that there is some reason for those papers being missing. I am speaking of this from the standpoint of experience also. I think that all papers ought to be kept separate from the note itself, and the note itself be filed in the note department or in the teller's case, filed properly in one of the steel cabinet drawers. That will afford better opportunity to run those notes for trial balance purposes periodically.

W. H. LINDSAY (Provident Trust Company, Philadelphia): Are you speaking of mortgage loans on real estate or are you speaking of mortgages that are pledged as collateral for notes?

THE CHAIRMAN: I took it your question was the collateral.

MR. KOEBER: Collateral held with notes.

MR. SIMMONS: My understanding was that it included mortgage notes.

MR. LINDSAY: I feel the other way, that they ought to be filed the same as ordinary collateral with the note, just as you would file your bonds and stocks, because that is the place where you make the examination. All that is under joint control anyway, so why have two places? If you want to control the mortgage loans or the application, the way I should do it would be to nail it before the loans are actually made by the officer, and verify the voucher for the advancing of money to the borrower.

JESSE J. FINN (Union National Bank, Schenectady): The paper made the point that a bookkeeper should not be kept on the same set of books too long. Our bank feels that it is an advantage to have bookkeepers on the same set of books for quite a considerable length of time, for various reasons, chief among which is that they are thoroughly familiar with the signatures of the particular customers in their division and also that they have an opportunity to become personally acquainted with those customers over a period of time and can, therefore, not only keep the accounts in more efficient condition, but also, by their personal touch with the customers, have a knowledge of their tendencies, and so forth, thereby making the customers feel better satisfied and freer to do business with the bank.

I should like to hear what the reasons are for recommending that the bookkeepers be kept on a shorter period of time.

J. FRED BROWER (Wachovia

Bank & Trust Company, Winston-Salem, North Carolina): The question has been brought up in Mr. Tompkins' paper in regard to continuous audits. Continuous audits are very expensive because in a large institution with spot audits, properly managed, we can have just a few auditors and then accomplish the work very satisfactorily. With the continuous audit, it would take several times that number.

It is best on the spot audits to have the force so arranged that they could rotate, or more than one be in charge of one separate department.

I see what you mean by the bookkeepers' being more familiar with the accounts. I think it is very important that the tellers do not rotate because they come in personal touch with the public, but with the proper signature cards, I don't think that that would cause any difficulty with the bookkeepers.

There could be a manipulation with the bookkeepers and statement clerks handling that same class of accounts, but if you say you have ten or more bookkeepers, if you could rotate them occasionally, it would be a help to the auditing department.

I sometimes wonder whether it would be advisable to have a continuous audit; that has been discussed with our executive officers, but we feel that the expense probably would not be worth it, so we try as best we can to put at least two in charge of every section or every department in our institution.

LOUIS SCHAEFER (Boulevard Bridge Bank, Chicago): In remarking about the rotation of bookkeepers, it is a policy of the Chicago Clearing House Association to recommend to banks under examination that they ro-

tate their bookkeepers at least every six months.

MR. KERR: I might mention that in our bank at home at least the tellers do not rotate, but the tellers are the ones who verify the signatures.

ALFRED J. BLASCO (Commerce Trust Company, Kansas City, Missouri): Speaking of bookkeeping departments, I just want to mention a point there on the exercise of controls, especially the inactive account control. That evidently is a sore spot in every bank. We exercise a good control in that by the separation of the signature cards and the ledger sheets themselves. We place the signature cards under the control of two operating officers in the commercial division, who have no access whatsoever to the ledger sheets. We place our ledger sheets under the supervision of the bookkeeping department manager and assistant. Primarily it is a matter of convenience. If any charges go through to those accounts, those accounts must be transferred back into the active ledger bearing both the approval of the manager of the bookkeeping department and also of the operating officer, one to vouch for the authenticity of the signature, the other simply to vouch for the sufficient promise to cover.

THE CHAIRMAN: That appears to be quite a good solution.

CHRISTIAN DJORUP (Christian Djorup & Company, New York): In my own experience, I collected \$125,000 from a surety company for a bookkeeper who manipulated an account for a period of three years. He was always on the same ledger account, and that defalcation grew to the extent of \$125,000. That is why I think the bookkeeper ought

to be shifted as frequently as possible. Besides, when they read statements they should change bookkeepers, reading the ledger accounts to the statements. The bookkeeper should not be permitted to read his own balances to the man who keeps the statements.

EDGAR L. UHLIK (Security First National Bank, Los Angeles): I am not connected with the auditing division, but I do have charge of collections and transit work. In that phase of work we are very often called on to make reversal entries. Reversal entries are dangerous and I can see where you can set up control on reversal entries on bank accounts. Where do you get your control on the individual accounts? Where do you get your control on reversal entries on commercial accounts?

MR. DJORUP: All reversal entries are usually passed by the auditor. No reversal entries should be permitted except when oked by the auditor.

MR. UHLIK: That means some control over your check files.

MR. LINDSAY: Suppose you credited the wrong accounts. What is to prevent the bookkeeper from taking it out of the wrong account and putting it into the new account? You would have to have a man alongside of every other man.

MR. BROWER: Our method is that the head bookkeeper only makes those entries and then hands the certificate to be approved by an assistant in charge of that department; they are seen every day by the head of the auditing department at the close of the day.

THE CHAIRMAN: What you are saying is that some one who is fa-

miliar with the accounts themselves and supposed to know what should take place, is assigned the responsibility of okeing those entries.

ELMO COX (Peoples Trust Company, Little Rock, Arkansas): Do you feel it is good practice to verify directly with the borrower the collateral that he has pledged against his loan?

THE CHAIRMAN: There is no question in my mind but that it would be a good thing. We have run across the problem and in some localities they say it is inadvisable to do that, and it is not done, but good auditing, to my mind, would call for reasonably frequent verification of the collateral with the customer.

MR. SIMMONS: I agree with you on that point. I might say that in our bank we verified collateral at the time of the annual directors' examination, and after verifying all loans over \$500, we received in a return envelope from the borrowers about 70% of all verification requests sent out, which we consider a very good return. Of the remaining 30%, a small portion of those came into our executive offices and registered some very strenuous protests against that practice, because of the fact that although there were certain things that their private secretaries handled, one of the things they did not handle was the ownership of the collateral that

they had pledged to their loan, insurance policies, and other things.

We discontinued that practice two years ago, after having carried it out three times, the second time, one year after the first; and the third, two years after the second. We have discontinued it entirely until we employ outside accountants; this would be about every five years.

MR. DJORUP: In one of the banks, excess collateral was taken out of the envelopes and put into those envelopes where collateral was needed to make the loan properly secured. That can be found out only by communicating with the borrowers. That is why I am in favor of having the collateral verified periodically directly with the borrowers.

MR. SCHAEFER: I might say that it is the practice of a number of the Chicago banks not only to verify the collateral pledged at least annually, but also to verify the unsecured loans by having a verification of the loan liability. That is done either annually or periodically by taking certain divisions of the alphabet. That has met with quite a measure of success. We do find cases where a second request has to go forward, sometimes a third request, but we find that possibly 90% of the requests sent out are answered, and I would say from that percentage that that would make a mighty fine audit.

Trust Department Auditing

By RUSSELL F. THOMES

ASSISTANT VICE PRESIDENT OF THE CENTRAL HANOVER BANK AND TRUST COMPANY, NEW YORK, NEW YORK

Address before the Denver Departmental Conference

"The bank auditor is in a highly specialized profession," says Mr. Thomes. "He must have a thorough knowledge of every function of his bank; he must understand banking laws; he is an accountant; he is a statistician; and, above all, he should be an executive of his bank."

As he interprets broadly the general functions of the auditor, so Mr. Thomes conceives the particular duties of the auditor with respect to the trust department as being of far reaching importance. He is concerned specifically in this paper with such matters as the setting up of an audit control of trust holdings, the use of "in" and "out" charges in safeguarding the permanent or temporary withdrawal of securities, and the checking of the income from trust holdings.

EVEN with all proper weight given to modern developments in American finance, such as the trend toward mergers, the extension of branch and chain banking, the facilities granted by the Federal Reserve System, and our entrance into the international field, I believe the development of the trust company to surpass them all in significance. This is so not alone because of the intrinsic importance of the movement, but also because it is a field in which practically all of the banks in the country can participate to a greater or smaller extent. It represents an opportunity for diversification of banking activities, and the need for such diversification is just as important in our field as it is in agriculture or trade in general.

If the history of trust work were relatively recent, or if practice had yet to be developed regarding the problems of the business, one would hesitate to make a statement as

broad as the above. But we can look back over a long period of growth and development, and we have the additional force of the record to help us. It is a most satisfactory reflection that, although bank failures have not been rare, there is no instance of an impairment of trust funds, although losses may have been suffered by stockholders and in certain cases by depositors. The fact that the inflexible rule has been followed, that trust funds must be kept apart from those belonging to the company, has safeguarded most adequately the integrity of the corporate fiduciary.

HISTORY OF TRUST DEVELOPMENT

The first grant to a corporation authorizing it to perform the duties of a trustee with the same powers as those enjoyed by individuals, was made by the State of New York in

1822. This marked the beginning of the era of trust companies, and until comparatively recent times these were the only legal entities empowered to exercise trust functions. It is significant that the first corporation to use the term "trust company" as part of its corporate title celebrated its one hundredth anniversary last month. The growth in the number of trust companies was slow until about 1875, when there were thirty-five in the United States. By 1900 there were over five hundred companies widely distributed throughout the country. During the present century, development has been sharply accelerated, particularly by the provisions of the Federal Reserve Act of 1913. Today there is no city or town of importance in the United States that has not its trust company or its bank empowered to exercise trust functions; in fact, recent statistics show that the trust companies and financial institutions empowered to act as trustee, are holding trust assets in excess of the total resources of the banks of the country. So much for the history.

You will note that I have made no mention of the auditor. A comparatively new arrival in the banking field, he played no part at all in the early history of trust work. He is here to stay, however, and his work in connection with trust activities is no small part of his responsibility. It is obvious that in exercising trust functions on the present-day scale, a bank having fiduciary powers must establish an accounting system of extreme accuracy and reliability.

Some of you may have the impression that a trust system and the audit control of a bank having a large trust department may not be applica-

ble to your needs. As I see it, this is true only in so far as a large trust business finds it necessary to subdivide the work into more ramifications. The greater the volume of business, the more work the auditor has to do. I am going to describe a method which I feel is applicable to the average size bank. In doing so I am centering my efforts on the work of the personal trust department, for in that field most of you are undoubtedly more interested than in general fiduciary work.

SETTING UP AN AUDIT CONTROL

In setting up a control, your individual problems will vary. If your bank is in the process of creating a trust department, your task is comparatively simple, but, should you have a well established trust department, the setting up of an audit control is an entirely different problem and one that, to avoid duplication, may involve changes in the systems of the trust department. In order to control trust holdings there is a considerable amount of information that the auditor must have, and the systems and procedure of the department should provide this for him.

When securities, mortgages, and so forth, making up the corpus of a trust account are first received, they should be recorded in a manner to develop the necessary posting medium for the various records of the department, such as the security ledger, the collection record, and the vault. For this purpose we use a carbonized form, which produces in one operation sufficient copies for the various subdivisions as well as for the auditor. These forms, known as "in" and "out" vault charges, con-

tain a complete description of the security and are numerically controlled, so that the auditor can ascertain that he has received all copies. Securities received in the vault are accompanied by the auditor's copy of the "in" charge, which is checked and initialed by the vault officer and routed by him directly to the auditor.

THE USE OF "IN" AND "OUT" CHARGES

If you will assume that your bank has just entered the trust field and has received its first trust account, the securities having been receipted for, properly charged into the vault, and recorded on the records of the trust department, you will perhaps see very little work for the auditor. He, nevertheless, has entered the scene and has a definite duty to perform. The condition I have pictured is probably not one that would exist for long, as there are bound to be changes in investments, maturities requiring reinvestment of funds, and various other activities, which increase with the growth of the business. Upon the opening of a new account, a copy of the receipt for the securities is routed by the signing officer directly to the auditor, who matches it against the "in" vault charge, to determine that all the securities are properly lodged in the vault. The control begins to function in an active way on withdrawal of the securities. Securities charged out of a trust are handled on an "out" charge, which works conversely to the "in." These charges are not cleared by the auditor until he has verified the receipt and credit of cash in the case of sales, or has seen a proper receipt in the case of deliver-

ies. "Out" charges covering the delivery of securities for exchange, such as temporary bonds for definitive bonds, are not cleared until the auditor has received a copy of the "in" charge, showing receipt of the new securities by the vault.

The cash is controlled through the medium of duplicate credit and debit tickets, the totals of which are verified daily with the general ledger control. Tickets covering receipt or disbursement of principal are set up by the auditor to be matched against "in" or "out" charges. In other words, when the auditor receives an "out" charge showing a delivery of securities for sale, this is not cleared until he has received a ticket showing a credit to the trust account of the proceeds of the sale. Likewise, should he receive a debit to principal cash for the purchase of securities, he matches this against his vault "in" charge. He has a further control over the cash disbursement through the treasurer's check account, which is under daily control.

Instances will arise where it is necessary temporarily to withdraw securities from the vault. We found that the handling of such a transaction on the regular "out" charge slowed up the work and made for unnecessary bookkeeping. We have therefore introduced a temporary withdrawal form, which is made up by the security clerk in three parts. On this form are shown the name, number of the account, a brief description of the securities, and the reason for the withdrawal. Two copies are sent to the vault. The vault officer delivers the securities, retains one copy as his receipt, and routes the other to the auditor. Upon return of the securities to the vault, the vault

officer sends his copy to the auditor, who matches it against his own copy to clear the item. All open items are followed up after two or three days. This form has proved so satisfactory that it is being used on all withdrawals. On permanent withdrawals the security clerk later makes up an "out" charge to complete the transaction. The auditor's copy is sent to the vault officer, on receipt of which he releases his temporary ticket to the auditor, who matches it against his copy to clear the temporary part of the transaction. The use of the temporary withdrawal has been a big time saver and permits greater promptness in the delivery of the securities, which is particularly important in the case of sales. Temporary withdrawals must, however, be watched carefully by the auditor.

If the trust holdings have been verified and found correct and all changes made under a control such as I have described, you can see that increases or decreases in these holdings cannot be made without the auditor's knowing it, except, of course, where securities are deliberately misappropriated. This is difficult to prevent completely, but proper audit control will minimize the risk.

It is the practice in many banks to maintain a control of the securities by accounts which are posted daily from the "in" and "out" vault charges. It is my opinion that such a control means very little and accomplishes nothing. The security records in the trust department should be so set up that they reveal at any time the holdings of each trust account, without the need of any bookkeeping in the auditing department. The responsible officers are interested in knowing at all times that the se-

curities held in trust or safekeeping are actually in the vault, and a duplicate record, even in skeleton form, maintained by the auditor, will not assure them of this, any more than if there were no such record. This can only be determined by a physical check of the securities. If it is the policy of your bank to insist that the auditor have a record of the securities, this record could be maintained without any bookkeeping on the auditor's part, by having the "in" and "out" vault charges so designed that the auditor's copy could be filed in a binder, in the nature of a ledger sheet. This method has been worked out very completely by the Federal Reserve Bank of New York, and is called the "trust receipt system." The bank does not, however, maintain a control in the auditing department. It uses a copy of the "in" and "out" vault charges as a ledger page and develops its security records without any additional bookkeeping. There is considerable economy in this method, to say nothing of its accuracy. The "in" and "out" charges should be thoroughly checked in every instance, and when these are posted to a security ledger they are assumed to be correct; therefore, by using a copy as a ledger sheet, the bookkeeping costs are materially lessened and errors in transcribing the information are eliminated.

CHECKING THE COLLECTING AND CREDITING OF INCOME

The collecting and crediting of income is a very important function of the trust department and one that should concern the auditor. In many banks which have large trust depart-

ments, however, it is not the practice to have this work checked: they rely on the customer to complain if he does not receive his income. We maintain, in the auditing department, a file record, arranged alphabetically by securities, which shows under each security the amount held by accounts of that security. Stocks are separated from bonds, which are subdivided by interest dates, such as January and July, February and August. The duplicate tickets which form part of the auditor's daily cash control are sorted alphabetically by securities and checked to this file. All exceptions are investigated immediately. For each \$1,000,000 of trust holdings the trust department will receive approximately \$50,000 income annually. A trust department with \$10,000,000 of trust holdings is not a large one, yet the income will be \$500,000 a year, certainly an item large enough to check, and, as the work is spread over a twelve-month period, this is not a heavy task.

These functions constitute the auditor's control and are daily duties. His other responsibilities comprise the physical examination of securities and the trial balances of the cash and security ledgers. If the trust department is not a very large one, he might also check up the commissions charged. At any rate, he should make tests of this account from time to time.

Trial balances of the ledgers should be made at least twice a year, and the physical check of the securities at least once a year. Most of you can do this more often, but, in a bank that has a large volume of trust securities, once a year should be sufficient. Lists of securities should be mailed to customers for

confirmation, especially in the case of safekeeping accounts.

You will find that your security clerk, if he is handling many transactions, will have hold-over items from time to time. By that I mean securities received too late to be put through, securities awaiting instructions, and so forth. The auditor should frequently examine the hold-over items.

Obviously, in this short paper it has been possible only to present a small cross-section of the work; any effort to describe auditing practice in the complete fiduciary field would mean a volume or volumes of substantial size. Let it be understood, however, that the entire field has its technicalities and problems, and the auditor must know them all.

THE AUDITOR'S FUNCTIONS

Although it is not part of my subject, I am going to ask your indulgence for a few minutes while I attempt to place before you the functions, as I see them, of the auditor in banking and trust work.

It would be helpful if I could distribute at this meeting copies of an article entitled *The Bank Auditor*, written for the *National Auditgram* by Craig B. Hazlewood, Vice President of the First National Bank, Chicago, and formerly President of the American Bankers Association, for in this article Mr. Hazlewood describes with peculiar insight the work before us. In any case, however, the following quotation will present the situation clearly: "I believe," says Mr. Hazlewood, "that a bank auditor is in one of the most strategic positions in relation to the management of a bank; no officer can have

more facts at his command and none can project his influence further in the direction of sound management."

The Standard Dictionary gives the definition of an auditor as "one who audits accounts; one who listens, a hearer." Is your auditor merely that, or is he a force for sound management?

The American Institute of Banking has summarized the auditor's functions, which summary you are perhaps familiar with. While this summary covers his duties completely, I believe that it has missed an important point. The auditor should analyze the assets, the mere audit as to their correctness not being sufficient. It is good as far as it goes, but it fails to reach the fundamental problem. Mr. Hazlewood refers to the auditor as a constructive force for sound banking. The auditor of the present day is not what the Standard Dictionary calls him. The bank auditor is in a highly specialized profession. He must have a thorough knowledge of every function of his bank; he must understand banking laws; he is an accountant; he is a statistician; and, above all, he should be an executive of his bank. Those of you who are auditors should make this your goal. To those of you who are bank officials I suggest that you think twice before denying your institution a man with these qualifications.

Discussion

HARWELL F. SMITH (Alabama National Bank, Montgomery, Alabama): It is not quite clear to me how you control income without keeping a record of the securities in the auditing department.

MR. THOMES: Possibly in that point I have contradicted myself slightly. This record is by securities and not by accounts. Under the title of security, for instance, steel, we have the name and number of the account and the amount each holds. It is a very simple little file on a cardex unit, not used for record purposes at all, and they slip little signals in there as the tickets are checked.

MR. SMITH: You really have a record of the securities?

MR. THOMES: It is in a sense. It is what somebody might call a property index record. It corresponds to the record that you should have of those who hold this and that security. It is not a record that has to be posted in the sense that the auditor knows what Mr. Jones has and what Mr. Smith has. That is another phase entirely.

ALFRED J. BLASCO (Commerce Trust Company, Kansas City, Missouri): Speaking of auditing the income, I should like to tell you what we do, and I should like to have you shoot holes through it. We don't believe in checking every entry, but in some cases we almost have to do it to make sure that the income actually has been credited to that account and distributed in accordance with the agreement.

We use the addressograph plate. These plates are run monthly. One copy of that goes down to the vault custodian and the other copy is a trust credit itself. An authorized representative of the trust department, together with the vault custodian, clips these coupons. They then go to the bank's coupon teller who proves them with the trust cashier who has these income credits. Those

totals must correspond. If they don't, then they have to check for the difference.

Let's not leave it at that point. Let's check it through to the trust ledger bookkeeper. The ledger bookkeeper is charged with these various credits. They are then run on the trust income record. We run them twice on our sheet because first they must be run on the ledger sheet itself and later, on the ledger security sheet.

Our purpose is to make it possible for the auditor to check only the security sheet itself. If that security sheet calls for \$10,000, say, some bond due in January or July (it happened to be January first here), he sees to it that on January first, 6% on that \$10,000 actually has been credited. We know that that security sheet is correct because the trust ledger bookkeeper makes two runs of credits, and since the journal is posted simultaneously, we look right on the journal sheet itself and see where these two total income credits correspond.

JACK GORMLEY (First Seattle Dexter Horton National Bank, Seattle): How many trust companies run a trust department trust blotter with a tie-in in the trust department?

THE CHAIRMAN: The gentleman has asked how many tie their trust cash into the general cash of the bank.

WILLIAM H. SIMMONS (First City Trust & Savings Bank, Akron): You mean that the trust teller's cash would be considered in the general proof of the bank cash the same as that of any paying or receiving teller?

MR. GORMLEY: Yes, and would be handled on your general ledger.

THE CHAIRMAN: Let's have a

showing of hands. (A few only) Russell says if they don't, they should. Mr. Djourup asks how many don't. Let's see that, too. (Only a few hands) Perhaps a very small number here have trust departments.

W. H. LINDSAY (Provident Trust Company, Philadelphia): Do you mean tied into the books as part of the cash balance of the general ledger?

MR. GORMLEY: It wouldn't be in with your general cash. It would be kept separate.

MR. LINDSAY: We can't do it in Pennsylvania. We have got to keep an altogether separate set of books in Pennsylvania, and it can't enter into our corporate ledger at all. It has to be a separate transaction, not mingled with the company funds.

THE CHAIRMAN: Are you a member of the Federal Reserve System?

MR. LINDSAY: Yes.

MR. THOMES: You have to keep reserve on it, then.

MR. LINDSAY: No. We keep it in another bank. We are not allowed to keep it in our bank unless we set up sufficient collateral to cover it. The way we get around that in Pennsylvania is to keep a reciprocal account in another bank.

THE CHAIRMAN: That is done in a great many cases. However, you are required to maintain a reserve at the Federal Reserve bank on the reciprocal account with you.

MR. LINDSAY: It cannot be put in the general corporate funds in Pennsylvania.

THE CHAIRMAN: That is because of the particular laws in your state, but it is tied into the cash in some other bank, at least.

PAUL H. HOITMAN (Bank of

California, San Francisco): I was just going to say that where the bank keeps the money in its own bank, that is trust money. Is that logical banking? We do it in our place. We put it in the savings department. In other words, we are using trust funds in our own loans. The question has often come up in our bank whether that is right or not, or whether we should deposit that in some other bank.

H. C. RUBERT (Fidelity National Bank & Trust, Kansas City, Missouri): If the securities are taken out of the vault for collection, conversion into cash, are they removed under a temporary withdrawal ticket or under a permanent one?

MR. THOMES: Under a temporary withdrawal.

MR. RUBERT: Doesn't that mean that when your cash comes in you have got to take them out on a permanent?

MR. THOMES: Anything that is out permanently would be followed up by a permanent withdrawal later. In our work, there are a great many call bonds, and it is necessary to withdraw those. We will say that we have certain bonds that are going to mature on July first, and those bonds are withdrawn several days before that in order to prepare them. Some of them may be payable in Chicago, or other points. In order to have your remittances back as promptly as possible, you want to get your point of collection as promptly as possible, so we withdraw them on these temporary tickets, and if it is a temporary collection, that is verified by the auditor, but the out charge must follow that through to see that it is clear.

MR. RUBERT: In other words,

you have to make another withdrawal ticket, do you not?

MR. THOMES: Yes, but the temporary ticket is made; it only takes a moment to make it up.

MR. RUBERT: Couldn't you make up your permanent? How many copies do you need? We are using five there. Couldn't you make that up almost at the same time that you are making up a temporary of three?

MR. THOMES: You could, but if you make up your permanent, it goes through the work and the item is off the books.

MR. RUBERT: We hold up the remainder of our items and run only those items.

MR. THOMES: I don't see anything wrong with that as long as you are watching it, but I pointed out that the auditor has to watch those temporary tickets very carefully.

J. FRED BROWER (Wachovia Bank & Trust Company, Winston-Salem, North Carolina): In a medium-sized trust company that has total trust assets of thirty to fifty million and that same amount in the commercial department, would you suggest that the auditing department be divided, a certain one or two in full charge of the trust accounting with the daily check of ins and outs, and the others in the banking department, all to come together with a periodic audit?

MR. THOMES: I think that is the only way you could do it economically. We have to do that. We have our audit subdivided, but when we come to a check of securities, we borrow men that are auditing, say, the foreign department or the commercial department; the trust audit is a distinct function.

I should say that with thirty to fifty million of trust holdings you would probably have enough work to keep one man busy a good part of the day anyway.

L. E. SOLEM (State Bank & Trust Company, Evanston, Illinois): Where coupons from trust securities are sizable in amount, what departmental safeguards are taken to insure prompt crediting of matured items?

MR. THOMES: I think that scheme I described answers your question. The auditor gets these tickets and checks them out. With the exception of the first of the month, he follows those up the same day. We find in our trust department the majority of our income is received on the first of the month. The auditor does not go to the trust department and verify that those tickets have actually been posted to any particular account. Frankly, I do not believe that is an auditor's job any more than you would have your auditor go to your commercial books and check the day's deposits. I think that is being done, if I may apologize to Mr. Blasco, because it is a comparatively new departure.

Some of us are a little bit afraid of this trust business, and I have found from talking with trust men from coast to coast that they wrap their trust department in so much red tape that the ratio of profits for every dollar taken in is pretty well wiped out.

The trust official in one of the big San Francisco banks told me last fall that they had a ratio of about eighty cents to a dollar, and with the responsibilities that you are going to have and the bank's liability in trust holdings, if you can't operate a trust department with a better ratio than

that, you had better give the business up. You ought to have a cost of not over sixty cents on the dollar, and the bigger you get, the more you will cut out the red tape, not sacrificing thoroughness—but you will cut it to some degree.

We never go to our books and verify. If the operators of those machines cannot post correctly, that is just too bad, perhaps.

Frankly, I don't believe it is an audit function. Perhaps it is because of our size, if I may boast a little bit. The first of July we will have income tickets running between eight and ten thousand, and you can see what a job it would be for any auditor or group of auditors to check the accuracy of that posting.

MR. BLASCO: Perhaps I should explain further. We do not verify the tickets themselves; we merely review the security sheets. A security sheet represents a block of like bonds. It certainly is worth a small amount of time to go through these security sheets to verify that income has actually been credited. At least we think it profitable. In fact, we put one auditor on that particular job periodically every six months. In a very short time we know that all income due a trust has been credited to it.

MR. JOHNSON (International Trust Company, Denver): I would like to ask a question with respect to securities that we receive in the mail. What procedure is followed to see that those securities are properly controlled?

MR. THOMES: It so happens that the senior vice president of the Central Hanover Bank & Trust was formerly president of this gentleman's bank. They had a teller get away

with some cash a few years ago. The new president wrote our Mr. Smith and wanted to know how we had a control over cash. I remarked, "Mr. Smith, you have three good looking pencils and when you go to lunch and come back, you have only two left."

We trust the honesty of our mail receiving division to see that those are put through. I don't see how you can do it any other way unless you have some tie-in on your receipts at the post office. I find the only people who can get the post office to do that are the fellows in the Federal Reserve bank.

MR. JOHNSON: I wonder if I might ask another question. You mentioned tests in connection with trust commissions. What tests do you apply?

MR. THOMES: I was hoping no one would trip me up like that. We simply go to the agreements and then verify that those commissions that should be charged according to the original agreement of trust are charged, or if it is a savings account, are actually collected. It would be impossible in our institution to do it completely, but it is tested now and then to see that it is being done.

MR. BLASCO: How is it possible to control fully the earnings of the trust department? How do you insure that all fees accruing to the department for services rendered have actually been collected?

MR. THOMES: I think that refers somewhat to the answer to the other gentleman's question. In the corporate trust work, a great many of those commissions are done through billing. In other words, if we are a transfer agent to some security, the corporation is billed every six months

or every year, and we have a follow-up on that in the accounting section which is part of the general audit control center. Those are followed up closely, but in personal trust commissions, they are usually done by charging the trust cash accounts. It is not so easy to check them. They will vary materially. We do it by the test that I just mentioned.

MR. HOHMAN: Should an auditor pass on all changes of system in the trust department?

MR. THOMES: Most assuredly. Whether he has control over it or not, whether he is the man that passes on all systems of the bank or not, he must be in the picture somewhere, because a change, no matter how slight, may throw his whole scheme out. We have an ironbound rule that any changes, whether they concern the trust department or any other part of the bank, are taken up with the auditing section. That is a very important point. You should absolutely do that, and don't be afraid to keep fighting for it. I know what some of you fellows as auditors have been up against. I was up against it a number of years ago myself and many times an auditor through no fault of his own is held down by rule of thumb by some senior officer or possibly only an assistant cashier, or somebody like that. You have got a responsibility, and if you don't stick up for your rights, no one else will. Systems are a very important part of your job.

MR. HOHMAN: One more question. Cash accounts in trust are sometimes overdrawn. To make that good we have set up an advance cash account. In other words, we have to make payments if there is not enough money there; we get it from

this advance cash account. Do you charge the customer interest on that so-called loan?

MR. THOMES: Yes.

MR. HOHMAN: It doesn't amount to much in some cases.

MR. THOMES: It will amount to a lot of money in a big trust department.

MR. SIMMONS: Some one a few minutes ago spoke of carrying trust deposits in their savings. I just wondered if the Federal Reserve bank would permit them to carry that as a time deposit. Unless the entire balance is interest bearing, will the

Federal Reserve bank allow you to carry that as a time deposit?

MR. HOHMAN: I think I was the one to bring up that question. We put the trust money in a savings account. We have to keep 3% of our savings deposits as a reserve with the Federal Reserve bank. A year or six months ago the national examiners started questioning whether we should keep that trust fund in our own bank in a savings account. Of course we didn't want it to get away from us. It is still being debated. Some day they will just tell us to take it out.

Acceptance Accounting and Auditing

By CHRISTIAN DJORUP, C. P. A.

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Address before the Denver Departmental Conference

Mr. Djorup discusses bookkeeping methods, accounting, the auditing of transactions in acceptances, and the different classes of acceptances. He considers commercial letters of credit, acceptances under agreement, trade acceptances, and bank acceptances based upon the exportation or importation of merchandise, warehousing, domestic shipment, and sales. Under accounting and auditing, he explains the specific methods used in twenty-one different details.

BEFORE discussing the bookkeeping methods, the accounting, and the auditing of transactions in acceptances, it may be advisable to say a few words about the different classes of acceptances that a bank may deal with and their sources.

We have acceptances against commercial letters of credit, acceptances under agreement, trade acceptances, and bank acceptances based upon exportation or importation of merchandise, warehousing, domestic shipment, and sales, or for the purpose of creating dollar exchange.

COMMERCIAL LETTERS OF CREDIT

There are two main groups of credits, import credits and export credits; each is subdivided into foreign currency and dollar credits.

The import credit, as the name implies, is used for the financing of the importation of merchandise from a foreign country and may be issued in foreign currency or in dollars, and the

drafts drawn under such credit may be accepted or paid either by the bank issuing the credit, or by some other financial institution specified by the issuing bank.

In accordance with the liabilities involved, I like to segregate such credits into two groups, foreign import letter of credit and own import letter of credit.

The foreign import letter of credit is a credit opened by an American bank in favor of a foreign shipper for the account of an American importer. The drafts drawn under such credit are to be accepted or paid either by a foreign correspondent or by a domestic correspondent of the issuing bank.

When the credit is made available at a bank in London or in San Francisco, or at another bank or banker's in New York, and when the drafts are accepted, a distinct liability of the issuing bank to the accepting bank is created.

The own import letter of credit is

issued by a bank upon itself, and the liability created upon acceptance of the draft will be a liability to an unknown party, namely, to the presenter of the draft at maturity.

An export credit is issued in favor of an American merchant or manufacturer for account of a foreign buyer, or for his own account, and the credit may be made available at the issuing bank or at some domestic correspondent of the bank issuing the credit.

The foreign export credit is a credit issued on another bank, and a distinct liability of the issuing bank is created to the accepting bank when a draft is accepted under such credit.

The own export credit is issued by the bank on itself, and the acceptance of a draft under such credit will also constitute a liability to the presenter of the draft at maturity.

Under all credits, whether import or export, there is contingent liability of the customer who requests the issuance of the credit to the bank that grants the credit, but in the case of export credits the customer may be either the exporter or the foreign correspondent who requested the issuance of a credit in favor of an American shipper.

ACCEPTANCES UNDER AGREEMENT

To facilitate the financing of domestic merchandise transactions, whether shipping or warehousing, agreements are made between the borrower and the bank under which drafts are accepted by the bank.

The acceptance agreement will state the particulars of the draft which the bank will accept, the method of payment by the borrower,

the collateral pledged with or assigned to the bank, and the terms agreed to by the borrower which form the basis of such acceptance.

Frequently banks will release to the customer, under trust receipt, collateral received under acceptance agreements. It is important to note that there is only a lien like a chattel mortgage on property which originally belonged to the customer and that to be effective against other creditors in case of financial troubles, such chattel mortgage must be recorded.

TRADE ACCEPTANCES

A bill of exchange drawn by a merchant on a merchant in payment for a specific sale of goods, and accepted by the latter, is called a trade acceptance. It should be made for a current transaction and not in settlement of a prior obligation, like a promissory note.

A trade acceptance should state on the face of it that it has been made in settlement of a specific invoice, giving the date and number, and this information should be occasionally verified by communicating with the drawee or acceptor.

The value of a trade acceptance will be greatly enhanced if no renewals are permitted and if the purchaser is assured of the fact that it is drawn in settlement of a current merchandise transaction.

BANK ACCEPTANCES

When a bill of exchange is accepted by a bank, it is called a bank acceptance. Bank acceptances are rediscounted by the Federal Reserve bank and by the central banks of Europe at fixed published rates.

During the past twelve years an open market has gradually developed for bank acceptances, and they are now considered one of the most liquid investments of a bank. By the "open market" is not meant a certain fixed place where acceptances are dealt in, but the entire banking district. Brokers or representatives of banks will go from institution to institution buying and selling bank acceptances.

ACCOUNTING AND AUDITING

For every letter of credit issued, there should be a folder containing all documents and correspondence referring to such credit. A triple record should also be kept, with short reference to customer and beneficiary, one set in numerical order, the other in alphabetical order of customers and of beneficiaries to facilitate ready reference to the respective credit when cables are received referring to a number or to one name only.

1. Application and agreement

For every credit issued for account of a domestic customer, there should be an application and an agreement signed with the authorized signature of such customer and initialed or signed by an officer or employee responsible for the issuance of such credit.

The audit department should inspect them from time to time and ascertain that these documents are in order for all new credits issued.

2. Letter of credit record

The entries in the letter of credit record are made from the application and the drafts drawn or advices received. The accounts are kept in alphabetical order as to customers, whether several credits are recorded

on one sheet or separate sheets are prepared for every credit.

The record should be so arranged that the totals of available credits not drawn against and of acceptances can easily be ascertained for comparison with the respective controls.

The letter of credit clerk should prepare the triple reference record, number, customer, beneficiary, and one of these can be used to prepare tickets or the entries in the letter of credit journal. He should prove his records frequently, at least bi-monthly, to the controls unless the audit department makes the frequent proofs and he need prove them only once a month.

If there are differences with the controls, it is proper to prove to the customers' liability records, which are prepared from the same sources as the controls.

It is important to set up additional credits for drafts in excess of available credits and to reduce contingent liabilities for canceled credits, unused portions, and credits that have expired.

3. Letter of credit journal

While many foreign departments prepare tickets to set up controls, I prefer the use of a journal which acts as a summary of transactions, is used as a posting medium for liability records, and will furnish daily total changes of controlling accounts.

When tickets are used, two tickets should be prepared at the time a credit is issued, charging "customers' liability under commercial letters of credit issued—not drawn against," and crediting the corresponding liability of the foreign department. When an acceptance is made of a draft under a credit, four tickets are necessary: (1) reduction of customer's

contingent liability; (2) reduction of bank's contingent liability; (3) increase of customer's actual liability; (4) increase of bank's direct liability. Therefore, twenty acceptances of drafts drawn under a letter of credit would necessitate eighty tickets; by using a commercial letter of credit journal, twenty acceptances will require only twenty entries and four tickets at the close of the day.

The letter of credit journal should show the date of entry, number of credit, name of customer and acceptor, kind of entry, letter of credit issued, acceptance, payment or cancellation, terms or maturity, foreign currency, and then four groups of four columns each subdivided into import—foreign and own—and export—foreign and own.

All foreign currencies are converted at an arbitrary rate, which remains unchanged, irrespective of market fluctuations; and, in case a close approximate dollar equivalent is desired for statement purposes, the difference between market and arbitrary rate can be deducted from, or added to, the sum total of the respective dollar equivalents.

In some foreign departments, all credits issued in foreign currency and drafts drawn thereunder are recorded in the foreign currency only, with a control sheet showing the respective foreign currencies.

The amount columns following the foreign currency column are subdivided into four groups, described as follows:

- a. Addition to commercial letters of credit issued
- b. Addition to commercial letters of credit acceptances
- c. Reduction of commercial letters of credit issued

- d. Reduction of commercial letters of credit acceptances.

In the first group are entered new credits issued and increases of credits issued previously. At the close of the day, two tickets are prepared for each column to obtain the proper increase for the controlling accounts.

The second group is used to record acceptance of time drafts drawn under commercial letters of credit. Only one entry is made to record acceptance of a draft, and at the close of the day four tickets are prepared for the total of each column to provide for the changes of the controls.

The third group shows cancellations of credits and of unused portions requested by customers; cancellation of expired credits, of which customers should be notified; acceptance of sight drafts, whether accepted and paid by the bank or by its correspondent; at the close of the day two tickets are prepared for each column to change the controls.

If the sight acceptance is not paid by the customer upon demand, it should be treated as an advance on account of a past-due acceptance until it is paid or a loan arrangement is made.

In the fourth group are recorded matured or paid acceptances to reduce the actual or direct liability of the customer and of the bank issuing the credits. Matured acceptances not paid are transferred to "past-due acceptances" or "advances on account of unpaid acceptances."

Under a revolving letter of credit each acceptance paid should be treated as an addition to credits issued, since the unused balance plus the unpaid acceptances should always aggregate the original amount of the revolving letter of credit issued.

The letter of credit record and journal are used for recording contingent and actual, or indirect and direct liabilities of customers and the bank. No actual payment of money is involved, and the aforementioned entries are made to record liabilities and controls only.

4. Receipts and disbursements

In connection with credits issued in dollars against which drafts will be drawn payable in dollars, the customer should pay at least one day before maturity of the acceptance. While some banks credit the amounts received direct to the customer's liability and charge their own payment to their own acceptance liability, it is advisable to keep the money transactions separate from the liability entries, and to credit "provision for acceptances," or some similar account, with the amounts received from customers, and charge the same account with the amounts paid in settlement of acceptances.

By comparing debits and credits in this account the auditor can easily see whether any acceptance paid by the bank has not been paid by the customer, or vice versa.

5. Liability record

The entries in the customers' and acceptors' liability records are made from the letter of credit journal.

There are shown the date of entry, the letter of credit number, and the kind of entry; then follow amount columns subdivided into several groups.

Under "commercial letters of credit issued" we have three columns: "foreign currency," "United States dollars," and "unused balances." These columns are used to record every new credit issued and any increase, and cancelations which later are entered

in red ink and deducted from "unused balances."

Under "commercial letter of credit acceptances" we have one group of three columns showing "foreign currency," "United States dollars," and "maturity here and abroad," and another group of two columns showing "credits or payments" and "balance outstanding." Every accepted time draft is entered in the first group, added to the "balance outstanding," and deducted from the preceding column, "unused balances." Every sight draft is entered in the first group, also in "credits or payments," leaving "balance outstanding" unchanged, and is deducted from "unused balances."

Up to this point the record proves itself automatically, showing first the contingent liability, which is reduced by cancelations or by acceptances shown alongside, which are deducted from contingent and added to direct liability. Sight acceptances reduce contingent without creating actual liability, as they should immediately be collected from customers.

Then follow a debit and a credit column headed "surety and margins" and "anticipated acceptances." One will be entered in black ink, the other in red ink. The balances of the two classes of payments will be extended in the respective total columns, and the sum total of both, deducted from the amount shown in outstanding acceptances, is recorded as net actual liability in the last column.

The auditor should frequently prove the liability records to the controls and inspect payments on account as well as anticipated acceptances to see whether customers are following terms of trust receipts when requested to do so. Larger borrowings should

also be compared with credit files to ascertain whether lines approved by discount or executive committees for credits or trust receipts are adhered to.

6. Surety and margins and anticipated acceptances

Two separate control accounts should be maintained, while the detail is recorded in customers' accounts kept in columnar form, showing debit, credit, and balance, each for surety and margins and for anticipated acceptances, and, besides, the number of the letter of credit and the maturity of acceptances.

A margin or collateral against a commercial letter of credit or acceptance consists of a deposit made by a customer in cash, securities, or something else of value, but only actual cash received will be credited to surety and margin accounts, while stocks and bonds or merchandise deposited or withheld as collateral will be recorded on collateral cards only.

Customers will usually state against which acceptance the payment made should apply, and, when sufficient payments have been made to take up an acceptance in full, the acceptance should be rebated and a transfer made from the customer's surety and margin to anticipated acceptances account and column.

On surety and margins there is sometimes allowed interest at a small rate. On anticipated acceptances interest will be calculated from the date of anticipation to the day of maturity. Sometimes there is also allowed a rebate of commission if the acceptance is paid more than thirty or sixty days before maturity.

Statements should be mailed to customers monthly, with confirmations to be returned to the auditor, who

should prove the detail records to the controls and the liability records from time to time.

7. Trust receipt

This is an agreement between banker and merchant, whereby the former delivers "his" property to the latter to be held in trust.

The banker will possess a valid trust receipt, a legal document authorizing him in the possession of the merchandise and of the proceeds thereof, only if the merchandise was imported in the name of the banker or bought and paid for by the banker; in other words, if the banker releasing the merchandise was the rightful owner of, or if he had title in, such merchandise.

The trust receipt should show the purpose for which the documents were delivered; how the merchandise was sold, if to be shipped to a third party; the terms and agreements as to selling, billing, collection, and payment of proceeds to the banker, as well as all precautionary clauses as to examination of records during business hours, and so forth; a complete description of the documents, quantity, quality, merchandise marks and numbers and value; the amount, letter of credit number, and due dates abroad and here; and the signature, which must be authorized.

Trust goods should not be mingled with other merchandise, and when sold should be invoiced separately. The insurance policies or certificates from insurance companies should be obtained by the bank.

The auditor should examine all trust receipts, see that no essential information is missing, and check from time to time to the letter of credit record to ascertain that all trust receipts have been received for mer-

chandise or documents delivered in trust.

The records of the customers should be inspected occasionally or at least should be verified by two forms: the first to show information as to direct liability or indirect liability, and collateral obtained from the records of the bank, which the customer should confirm; the second requesting information from the customer as to disposition of the merchandise held by him in trust, which should be closely examined by the auditor.

Customers of a bank are segregated into two groups: those who have a certain line of credit granted both on their own paper and under trust receipt; and those to whom the merchandise delivered under trust receipt is considered as collateral and who are called upon to live up to the terms of the trust receipt.

I have been strongly advocating for many years that banks should consider the release of merchandise under trust receipt more seriously, and that merchandise should only be released when subsequently it can be identified, and not when it is mingled with other goods or loses its identity in the process of manufacture.

8. Acceptances under agreement

Acceptances under agreement are being used to finance all kinds of merchandise transactions, as they enable the banker to grant credit without tying up his funds. They will be recorded separately from those under commercial letters of credit.

9. Acceptance register

While commercial letters of credit acceptances are entered in the commercial letters of credit journal, those under agreement are entered only in the acceptance register, showing date of acceptance, number, name of cus-

tomers, tenor, amount, due date, and disposition. If the acceptance agreement bears a distinct number, as does a letter of credit, such number will also be shown in the register.

The daily total of the register will be used to increase the controls for direct liabilities of the customer and the bank.

10. Acceptance tickler

This record, with separate sheets for each day's maturities, shows the date of entry; the letter of credit and/or acceptance number; the name of the customer; three amount columns, segregated into import or export, domestic shipment or sale, warehouse receipt; and a disposition and remarks column.

The daily total of the tickler will be used to decrease the controls for direct liabilities of the customer and the bank at maturity.

11. Acceptance record

Analogous to a letter of credit record is kept an acceptance record, with a separate account for each customer, which also serves as a liability record.

These accounts will show date of entry, letter of credit and/or acceptance number, tenor, amount, due date, two amount columns for credit or payment and balance outstanding, kind of collateral, trust receipt reference, and a disposition and remarks column.

This record should be regularly proved to the control by the department in charge of acceptances, and also it should be frequently checked by the auditor.

In many banks a separate section is carried in the commercial letter of credit liability record for liability of customers for acceptances under agreement, in which case the two

amount columns in the acceptance record can be eliminated.

12. Collateral record

After each customer's account there is shown the collateral upon which the acceptances are based, unless separate collateral cards are maintained.

For the purpose of checking, separate cards are preferred, especially when numerous substitutions of collateral and partial deliveries are made.

Besides comparing the value of the collateral from time to time with the acceptance amounts, the auditor should also see that sufficient insurance is provided for the protection of the bank.

13. Receipts and disbursements

The actual cash payments are treated in the same manner as those against commercial letters of credit. The amounts received from customers are credited to "provision for acceptances," the acceptances paid by the bank are charged to the same account, while customers' and acceptors' liabilities are reversed at maturity of acceptance.

Margins deposited and payments made on account of acceptances or in anticipation before maturity are treated in the same manner as the same kind of transactions under commercial letters of credit.

14. Trade acceptances discounted

A bank discounting trade acceptances will charge "trade acceptances discounted" with the face amount of the acceptances purchased, and credit "discount on trade acceptances collected—not earned" with the discount deducted at the time of purchase or discount of such trade acceptances.

Daily or monthly, the earned part of the discount will be charged to the latter account and credited to an earnings account like "discount on

trade acceptances earned"; "discount earned," or "interest earned."

A tickler and liability record for both the maker and the acceptor should also be maintained.

15. Bank acceptances

All acceptances made by a bank, whether under "commercial letters of credit," under "agreements," or under some loan arrangement for the purpose of creating dollar exchange, should be numbered consecutively.

A collective register, with columns for the different classes of acceptances, or separate registers should be maintained, and the officer or officers signing the acceptances should put their initials in the register. If only tickets are used, a coupon with the officer's initial should be placed in the auditor's box.

A complete tickler system should be maintained for all acceptances made by a bank or for its account. Where only Fanfold systems are employed, a carbon copy of the slip recording the acceptance will be used as tickler and filed under maturity.

Acceptances other than under "commercial letters of credit" and "agreements" will also have to be recorded in liability records and on sheets in a separate section of the "acceptance record" unless these are so numerous that it becomes advisable to maintain a separate record.

The auditor must see daily that every acceptance made by the bank has been properly recorded and that the respective controls have been set up or increased.

16. Own acceptances purchased

When a bank purchases its own acceptances, whether from the customer for whose account the acceptance is made, or in the open market, the items will be charged to "own

acceptances purchased." Cash or the account of the customer or bank which sold the acceptances will be credited with the net amount, and "discount on bank acceptances collected—not earned" will be credited with the amount of the discount deducted.

17. Acceptances of other banks purchased

Banks or bankers sometimes exchange acceptances with other institutions of different localities, and both institutions obtain funds available for use in the local market by rediscounting the acceptances received in exchange with the Federal Reserve bank, or by selling them in the open market.

The items received in this manner, or acceptances bought from institutions or in the open market, will be treated as described above and charged to "acceptances purchased."

18. Purchase and sales record

When an acceptance is sold or rediscounted, interest is earned on the acceptance, at the rate at which it had been discounted, from the day of original discount or purchase to the day when it is sold or rediscounted. Furthermore, a profit or loss is realized, consisting of the difference between the discount at the original rate, applicable to the period from the date of sale or rediscount to the maturity of the acceptance, and the discount which has been deducted by the purchaser or the institution rediscounting bank acceptances sold.

The purchase and sales record will show, on the left side, particulars regarding the acceptance purchased and the full discount collected—not earned; on the right side, the date of sale, the earned part of this discount, the unearned balance; and the last named, compared with the discount

deducted by the purchaser, will show the profit or loss. Then follows the total accrual plus earning or minus loss.

A tickler should also be kept for acceptances purchased, and, the date of sale being recorded, the open items in the tickler should correspond with the investment in own acceptances and in those of other institutions as shown by the controls.

A liability record should also be maintained for acceptances purchased of other institutions, and the totals should be compared occasionally with the lines fixed by the committee.

19. Internal audit

The total of the daily transactions should be proved daily to the changes in the respective controls. Frequently the customer's direct and indirect liability should be compared with the bank's corresponding liability. In case of difference from the controls, a comparison of the liability records with letter of credit and acceptance records should show whether the controls or the detailed records are correct.

The trust receipts on hand should be examined frequently by the auditor, particularly those against acceptances under agreement.

Acceptances purchased and the documents held for merchandise not delivered, as well as other physical assets, like stocks and bonds received as margin or collateral, should frequently be examined by the auditor.

20. External checking

The records of customers to whom merchandise is delivered against trust receipt should be examined from time to time. If this is not feasible, they should be proved by communication, the two forms mentioned under trust receipts being used.

Foreign correspondents should be requested to send lists of available credits not drawn against and of acceptances monthly.

Active customers whose auditors do not request verification of acceptances should be requested to confirm bank's letters or to submit lists of unpaid acceptances at least once a year. The auditor should also see whether future contracts have been made by customers to protect themselves against losses on acceptances in foreign currencies.

Statements should be sent of accounts for payments on account and anticipated acceptances and to foreign correspondents who issued letters of credit available on us, to verify unused balances and acceptances outstanding.

21. Analysis of earnings and expenses

Earnings resulting from services rendered customers without involving an investment of funds should be kept separate from those requiring a capital investment.

The interest earnings should show amounts received or paid on own or other acceptances, rebated acceptances, surety, and margins.

The commission section should show commission on letters of credit, subdivided into foreign and own import and foreign and own export, acceptances under agreement, finance bills, or other acceptances.

Only on foreign import and export credits, commissions will also be paid to the accepting banks, and by segregating controls and earnings and expenses it becomes an easy matter to prove earnings accounts to average amounts shown in controls for certain periods.

The expenses of the foreign de-

partment are frequently carried on the general ledger of the bank where all expenses are recorded. But even then it is advisable to have the direct and overhead expenses in such analytical form that, by comparison of earnings and expenses, it is easy to determine which branch of the foreign department is progressing and which branch is unprofitable.

Discussion

MR. DJORUP: I might mention that when we were down in Dallas, Texas, one of the officers of the bank stated that they were using a trust receipt in the following manner: the bank was giving advances to the mill. The mill got cotton from the shipper and gave the bank a trust receipt for the cotton for which they paid the shipper with the bank's money. In that case, for instance, the bank never owned the cotton. It was just a chattel mortgage and should have been so recorded. After we got through, they changed their trust receipt method down there. Some of you may have had some similar experiences.

PAUL H. HOHMAN (Bank of California, San Francisco): By trust receipts, do you mean also warehouse receipts?

MR. DJORUP: You have a trust receipt where the merchandise is delivered to a customer against his trust receipt. It states "trust receipt" on it. It is against the merchandise in trust and is to account for the proceeds to the bank. When you first hold a warehouse receipt of the customer, you hold that as collateral to a loan. If any part of that merchandise is delivered to the customer, it should not be delivered against the

trust receipt. The merchandise was not your property; it was the customer's property because he gave you a warehouse receipt. It is a chattel mortgage and should be so recorded. A trust receipt is not a legal document. If a customer goes into bankruptcy, you can't collect the money. You are just a general collector like the rest of the common herd. I have been in a number of bankruptcies.

LEON H. HUNTER (New Britain Trust Company, New Britain, Connecticut): What commodity control, if any, should be maintained?

MR. DJORUP: Large banks will have large amounts of money out on acceptances which are secured by merchandise. When a bank holds, let us say, coffee to a large extent, to several million dollars' of acceptances, it ought to know at least the market price of the coffee which is collateral to the acceptances. If it has sugar or rubber or raw silk, the bank ought to be interested when the raw silk price goes from twelve dollars to six dollars a pound, and if it goes from six dollars to four dollars a pound, and each bank that goes into the acceptance business should have a merchandise man or some one who familiarizes himself with merchandise values; the bank should keep a control also over the merchandise in order to spread its acceptances over as many different kinds of commodities as possible, as well as over different localities.

WILLIAM MCARTHUR (First National Bank and Trust Company, New Haven, Connecticut): I should like to ask Mr. Djourup if he feels that it is the duty of the auditor to follow the price level of commodities.

MR. DJORUP: That should be the duty of the merchandise man or

the head of the foreign department, but the auditor at the same time should also see that the foreign department has proper records of the price level of commodities to see whether the acceptances are properly secured; not continually, but from time to time, the same as you want to know whether loans are secured by stock exchange collateral; whether the proper system is kept in the bank; and whether the margins are checked from time to time; the auditor should from time to time see that the proper margin is maintained.

MR. MCARTHUR: I had in my mind particularly that most auditors would not be familiar with commodities to the extent that some merchandise men directly connected with the department would be, and I wondered whether it would be left entirely to the merchandise men in the department or whether the auditor should try to find out something about these commodities and make it a part of his job.

MR. DJORUP: The auditor should make it part of his job; as auditor, if I get into a crude rubber house, I write to a number of rubber houses to get the market value of a certain grade of rubber.

The auditor of the bank should be just as much interested in finding out what collateral the bank has and what the value is, as the directors' examiner would be when he came into the institution, for in many banks the directors' examiner from the outside comes in only every five years, where the auditor of the bank should do the same work that the directors' examiner would do at least once a year.

RICHARD C. HUELSMAN (The Midland Bank, Cleveland): I was

interested in your form to find the status of the collateral. I am wondering how good the trust receipt is after the goods are in process of manufacture. After a certain stage, it is almost impossible to identify your collateral or your goods delivered on your warehouse receipt. For instance, in the case of an acceptance against an importation of oil, the oil may go into paint. Other things go into that paint, and when the product is halfway finished, or finished, where is the collateral of your trust receipt and in what position is the bank in this respect?

MR. DJORUP: Where the original merchandise cannot be followed through and cannot be identified in the finished product, I would not give up the merchandise on a trust receipt, but in many cases the merchandise can be followed into the finished product and the bank will hold the additional value of whatever has been added to the merchandise if the trust receipt is properly drawn up. The bank will hold as collateral not only the goods delivered but also everything that is added to make the finished product ready to be delivered to the customer, or the borrower from the bank.

MR. HUELSMAN: If the goods

are still in the customer's plant, what control have you over it, or what will be your status under a receivership?

MR. DJORUP: It depends altogether on the agreement between the customer and the bank. That should be covered in the agreement, and the lot numbers should be recorded in the records of the borrower so that you can follow from the borrower's account what became of the merchandise that originally belonged to the bank. On that account it is important, as I brought out in my talk, that banks should from time to time examine the records of customers when they give them large lines of credits or acceptances under letters of credit and see that the products are properly earmarked in books of account of the borrower. Some of the banks in New York have men from their audit department go regularly into the offices of their trust receipt customers to find out whether they have properly recorded their transactions.

MR. HUELSMAN: Would their claim stand good where the goods have been changed during the process of manufacture?

MR. DJORUP: If the customer is to add material and labor to make another product out of it to deliver to the customer, it would.

Fundamentals of Audits and Accounting

By JOEL B. FORT, JR.

MANAGING DIRECTOR OF THE NASHVILLE BRANCH, FEDERAL RESERVE BANK
OF ATLANTA, NASHVILLE, TENNESSEE

Address before the Denver Departmental Conference

Mr. Fort believes that the auditor's main work is no longer to find discrepancies, but is rather to lead the way to better precautionary methods. The auditor must have leadership vision, as well as thorough technical knowledge. As important as either of these is the thorough understanding of the personnel with which he works. This includes a knowledge of the habits and living conditions of the individual as well as of his capabilities.

"Many a life might have been saved from remorse, and many a shortage might have been prevented, if only the auditor had known that the living conditions and the income of a certain employee were not commensurate."

It is the business of the auditor to systematize the various departments, so that there will be a maximum of efficiency and of conservation of man power and expense.

Examination is probably the greatest responsibility of the auditor. This should include the examination of cash holdings, of the entries in the general ledger, of the individual ledger controls, and of the savings ledgers.

THE banking business in the last ten years has grown into an intricate profession, and, as it continues to insinuate its tentacles into the very lifeblood of American business, we find rapid changes taking place daily.

One of the great questions of the day is group and chain banking. Unquestionably, one or the other of these systems has invaded the banking field to stay, and, with the inception of either of these systems, we find the bank auditor facing great burdens, great responsibilities, and, at the same time, great possibilities.

Among the first essentials of audit fundamentals, I believe we should

take up the auditor himself. In the mass of personalities and combinations that make up the human family, there are certain qualifications and personal qualities that are inherent; others have to be cultivated and acquired through personal effort. Webster defines the auditor as "a hearer; a listener." Under the old methods the auditor was to find the discrepancies after they had been made, but science has discovered that "an ounce of prevention is worth a pound of cure," and so the auditor of today, and tomorrow, must lead the way to better precautionary methods. He must have leadership vision, and, in the words of Kipling,

he must "walk with Kings—nor lose the common touch." He must be trained, and that training cannot all be gained from the written page. The school of hard knocks he should call his Alma Mater.

He should strive for the happy medium between the mechanical and the human elements; all improved methods of doing things start in the human element. Egotism on the part of the auditor will be a hindrance in both lines; every man we can call a success draws the confidence of others to him. He must love the technical, or get accustomed to it. He must be impartial, reasonable, and stern, and, as Lincoln put it, must have "horse sense."

The auditor's duties involve a thorough understanding of the federal income tax, state income tax, National Banking Act, Federal Reserve Act, and various other legislation, such as the McFadden Bill, the Farmers' Warehouse Act, and fiduciary matters. No other position demands so much as that of the man who gathers the tangled wires of a large institution and brings them together and makes a contact; he frequently gets a shock himself. The auditor should, moreover, adopt the slogan "Never ask a clerk to do anything that you cannot do yourself." Then we have a fitting preparation for the great profession of audits and accounting.

PERSONNEL OF THE INSTITUTION

A strong personnel is one of the greatest assets of any institution, and the auditor should have authority to shift and rotate wherever he sees fit, without being hampered by other executives. He need not necessarily

place his stamp of approval on new applicants, but merely become acquainted with their qualifications. No chain is stronger than its weakest link, but that applies to the mechanical only. It is the human element again that makes the heaviest demand on the auditor in dealing with the personnel and knowing their habits, their morals, and their living conditions. Here the study of psychology adds another course in the curriculum of the auditor. Many a life might have been saved from remorse, and many a shortage might have been prevented, if only the auditor had known that the living conditions and the income of a certain employee were not commensurate.

Employees should be shifted from one position to another, not at regular intervals, but at the will of the auditor. In his duties with regard to the personnel, he takes a retiring position as a listener and as a hearer, with his own morals and habits all that he would ask that others be.

SYSTEMATIZING

We next come to a fundamental in auditing that also takes its toll of the auditor's time, that of systematizing the various departments in his bank. Two important items might be grouped under systematizing, that of efficiency, and that of the conservation of man power and expense. Have you ever tried to cope with friction and lost motion? If so, you know how fatal they are to balanced and efficient operation.

I once mounted a little saw to saw up small timbers, and, when I had it all together and turned the power to it, it shimmied and walked all over the floor; I had to cut the power

off to keep it with me. It was worse than nothing in that condition, so I took it all apart; to the eye, however, it was right. After several trials I took it to the lathe and found that it did not balance; one side of the shaft was too heavy; so I turned it down true, and set it up. When the power was turned to it, you could not hear it run. So in systematizing, the auditor is balancing the elements with which he has to work, taking out the lost motion.

I believe that a good auditor makes regular surveys to see that all clerks are cutting the corners and taking the short routes. Here again the human element hits the stride. If a clerk is at home in a certain kind of work, he is best fitted to work out these short cuts. The mechanical follows the hard beaten path of antiquated practice; personality visualizes shorter and better ways; the auditor should encourage the development of initiative on the part of his employees. Lend a listening ear to the suggestions of employees. Every war has been won with its private rear rank and not its generals. When Napoleon was preparing his great drive on Moscow, with its snow and blasts, some captain asked him about the finances, and this was his reply: "Get your principles right and some private will work out the details." Details are cheap, but ideas and principles cost money.

Volumes and volumes have been written on system, and yet, for the most part, a system must be devised for each institution to fit its particular need; that is the work for the auditor.

Under the head of examination the auditor probably inherits his greatest responsibility. I believe that an au-

ditor should be a free lance, that is, he should report only to the president and the board of directors, and in many instances should sit with the board. Many auditors hold the title of vice president, or some other title, in addition to auditor, but it is my thought that they should never exercise the authority vested in them through such titles.

EXAMINATION

It is not my intention to go into any detail about examination, but merely to touch on some of the points in an examination that have caused the most grief. The cash holdings usually call for first attention, and a percentage count will, in most cases, suffice, but actual count should be made at intervals. I think that the condition of the cash should be observed as well, that is, kept in a way that is acceptable to the Reserve banks, according to their regulations, strapped and faced according to denominations.

The entries of the general ledger should never escape the eyes of the auditor in his examination. Many institutions require the auditing department to check every entry to the general ledger, and I believe it is a good practice, as it tends to keep the auditing department in constant touch with the bookkeepers, and facilitates examinations. Careful consideration should be given the individual ledgers, and, where the bookkeeper carries controls on his own books, these controls should be compared with the general controls even oftener than examinations are made. Employees on these books should be changed often, at the will of the auditor, but a great deal of tact should be exercised in

this, to avoid suspicion and to retain the good will of the employees.

The savings ledgers represent a real problem, the home of dormant accounts and the harbor of temptations. I know of one instance where a shortage in a national bank had been spread out over a period of twenty years, with all of its examinations, and was discovered only after it had sapped the life of the bank and could not be covered. In this case a forced vacation, or a shift of clerks, might have saved the accumulation of a whole lifetime for widows and orphans.

How to safeguard against such a possibility is the problem, and many schemes are being tried. Some auditors make a practice of checking the balances from the last examination with the new balances, with reference to the dormant accounts, and running down the withdrawals to see if they are regular. I understand that one or two machines have been designed to take care of savings, that will eliminate any fraudulent entries, but I am not very familiar with their work.

The bonds and securities held by the bank should be carefully examined, and a report as to their net worth submitted to the board after each audit.

I hope we have touched on some of the fundamentals that will tend to unify the principles of auditing and that will give us the power to visualize the demands that advancing time will call on the auditor to meet. It is not the things that are that call for study but the things that may be.

Discussion

OLIVER G. ELLIS (Ogden State

Bank, Ogden, Utah): Mr. Fort stated that the auditor should have nothing to do with the hiring of new help. Since the auditor is responsible for having the work done properly and efficiently, do you not think it would be better for him to question the applicant and check up his past record rather than have some officer hire a relative or some friend and wish him upon the auditor?

MR. FORT: Mr. Ellis, I think that would be a good idea if it were not carried too far. You know the auditor is not different from any other executive in the institution. He has no more moral stamina, he has no more resistance to temptation; he is just a plain, everyday man just like everybody else. The point I was making is this: that if the auditor delves too far into the passing on applicants, he will naturally want to nurse his applicants to an extent that may show favoritism and may not hold him far enough aloof from the personnel to demand the respect that he should have. For that reason, I think that if the auditor merely discussed the applicants with the hiring executive, he would be in no way obligated to the clerk as having brought him into the institution.

RICHARD C. HUELSMAN (The Midland Bank, Cleveland): I take exception to the remarks of Mr. Ellis. The auditor is not in charge of operations; consequently, he should be entirely divorced from operations. If he is, he is in no way responsible for the work the employees are doing. I think the auditor is in a much better position if he keeps out of the picture entirely, because if the auditor is going to hire the help, who is going to check the auditor?

THE CHAIRMAN: The question

of who audits the auditor comes up pretty often.

J. FRED BROWER (Wachovia Bank & Trust Company, Winston-Salem, North Carolina): I fully agree with this, because hiring help is just about the same as keeping an account yourself and then auditing it.

Mr. Fort, don't you think it very advisable, regardless of how small the institution is, for a bookkeeper to be separate and apart from the teller and the savings department, even if there are only a few savings accounts?

MR. FORT: I certainly do, because as I see it, by that method it would be impossible for either one of them to manipulate, inasmuch as savings checks do not come through any source except through the teller's cage. For that reason the bookkeeper would be unable to manipulate the books and the teller would be unable to get anything by the bookkeeper. I think that they should always be kept by some one other than the man who waits on the window. I thoroughly agree with you.

THE CHAIRMAN: It is always a good plan to keep in mind that when an auditor forces collusion before defalcation, he has gone quite an extent toward his duty. That is one of the fundamentals of auditing.

JOHN L. RYSKAMP (Old Kent Bank, Grand Rapids): In the case of a bank operating branches, should the auditor have charge of the branches or should some other executive officer have charge?

MR. FORT: I know of several cases where the auditing department controls almost outright the separate branches. I would not be in a position to answer that. My opinion would be that the same control should exist throughout the branches that

exists in the parent bank, although to a great extent the auditors on their rounds check up and report back and in some sense are the steering hand to the branches.

I rather think that the same policy of the operating of the branch should go through some other executive and that the auditor should stay in the background and merely report what he finds and recommend discharges to the source through which employment was made.

HARRY S. NOLEN (Baltimore Trust Company, Baltimore): I might answer that question for you. We have nineteen branch offices and they are looked over by one particular department which we call branch supervision. That is entirely separate from the auditing department. Then the examiner of the auditing department examines those branches himself and makes his report directly to the executive officers, giving a duplicate to the man having charge of the branch supervision. The examiner also comments on and criticizes personnel. If things don't look so good around the place and they feel as though the clerks are not handling the public properly and work is not just what it should be, the recommendation of the examiner is considered very seriously by the branch supervision.

C. M. ALLEN (Citizens-Farmers National Bank, Chickasha, Oklahoma): Is it wise for the auditing department to pay bills and transfer stocks?

MR. FORT: A great many auditing departments that I know of do that, but it has occurred to me that whenever an auditor performs a duty in the first instance, there is nobody to check it. I know of one large institution where the auditing depart-

ment pays the bills. When I asked the question, they said, "It gives us an opportunity of checking the bills." But after the transaction is closed, there is no examination to be put on the auditor's work. I rather think that the auditor's work should always be to check a duty that has been performed by some one else to see that it has been done regularly. For that reason I don't believe the auditing department should either transfer stock or pay bills.

JERE STRYKER (Federal Reserve Bank of New York, New York): What safeguards should an auditor employ to see that all income is credited on the general ledger?

MR. FORT: There are some auditors here that could probably answer that better than I can. Of course that is the bank's source of revenue, and I don't think we could check that part of the examination too closely. A great many auditing departments make a daily check from the notes themselves. After they have passed through the routine work they go to the auditing department, which refigures the interest and checks it back against the ticket going to the general ledgers to see not only that the total amount of interest has been credited, but that the total amount was collected from the customer. I believe it is very important that the auditor should check that and that he should check it daily.

THE CHAIRMAN: One of the most dangerous items of audit in a bank is income, because once the income passes over the dam, it is usually lost. If it is an asset or a liability item, the customer himself in many

instances will assist the auditing department in bringing it to light.

MR. HUELSMAN: In connection with accrual accounting, for those who are not familiar with it, I might say that we have a system which is used largely in the East. The bank has installed the system and I have never seen any accounting system of any kind that applies to earnings which will give you the control that system will. It goes into some detail to get your story, but it is one of the hardest things to beat, that I have ever seen. It practically safeguards your earnings and establishes a very good control over them.

ALFRED J. BLASCO (Commerce Trust Company, Kansas City, Missouri): I should like to ask just a question with regard to the rendition of reports. What would you suggest in making up a report so that the officer to whom you are rendering the report will absolutely read it all?

MR. FORT: I think the auditor's report to the head of a department in the first instance should be short and to the point. I think his report should go to the higher executive.

With reference to recommendation for changes in system, I think that the auditor might work that out with the head of a department without going through the board of directors or through the controlling heads, but certainly each department ought to have a copy of the report that he is making, whether he makes it directly to them or directly to the president. Each head of a department should be advised as to the opinion that the auditor has formed after examining the department.

Daily Adjustment Accrual Accounting

By RALPH L. WATTERS

LINCOLN BANK AND TRUST COMPANY, LOUISVILLE, KENTUCKY

Address before the Denver Departmental Conference

The achievements of Colonel Lindbergh have been invoked of recent years in many connections, but never before, probably, to illustrate daily adjustment accrual accounting. Nevertheless, Mr. Watters has drawn a close parallel in his interesting paper.

Besides considering the arguments for and against this method of accounting in general, and explaining its wide applicability and the best plan for its installation, Mr. Watters considers one method in particular—the aggregate basis method. His talk closes with this heartening prophecy: "Daily adjustment accrual accounting will cause your books to provide adequate reserves to care for all accrued liabilities and to reflect correctly all earnings not yet collected. By its use your institution can more readily reach the enviable position of having a healthy, growing surplus and undivided profits account."

WHEN that young man now familiarly known to us as "Lindy" took off from Roosevelt Field on that morning a little over three years ago, he was in one sense of the word, traveling an uncharted path. Yet he was not following a blind trail. It was for him to take into consideration the speed with which the propeller was turning, the air currents through which "We" were moving, and all the other factors that determined the speed and direction of the "Spirit of St. Louis." By weighing these factors one against the other, he was able to chart his progress and to know approximately where he was at all times. So well did he handle his plane and so accurate were his calculations that he dropped down on the field at Le Bourget without the

loss of any time in determining the proper landing place. Here was a splendid example of daily adjustment accrual accounting. Here was a goal to be attained, but for the attainment of which it was necessary to know at all times what progress had been made and what delays had been incurred. We might think of the plane itself as the physical equipment of the bank, the air currents and head winds as the operating expenses, the force of gravity as the overhead expenses, and Colonel Lindbergh himself as the personnel of the bank.

Accrual accounting has been defined as an endeavor to record profits as they are earned and expenses as they are incurred, in order that the books may reflect the true earning position of the bank. One authority

has said that the most important use of an accounting system is that of comparison. The figures of one period alone would be of little value in determining the progress of a business, but the figures of successive periods, when arranged in comparative form, are of much value. The importance of seeing that these figures represent the truth is self-evident. They will be of no value for comparative purposes unless each accounting period bears no more than its proper share of expenses and takes credit for no more than its proper share of income. If we wish to make our figures of much practical value, it is necessary to adhere to the accounting rule that "every expense should be distributed over the accounting periods benefited by that expense."

The cash receipts and expenditure method of accounting, on the other hand, takes earnings and expenses into account only as they are collected or paid, and, while the latter method is simpler, its figures must be averaged over a period of several years if any idea of the progress made is to be obtained. Where it is customary to discount most of the paper handled, it will be seen that large profits may be shown before they are actually earned; on the other hand, securities may be purchased and held several months before any income is collected. The point is well illustrated by the bank in the county seat town that asked to buy a comparatively large amount of paper from its city correspondent about December 29, so that it could show a nice earnings figure on its published statement as of December 31. Similar objections to the cash basis of accounting could be cited.

ARGUMENTS PRO AND CON

The argument has been raised that with an accrual system dividends might be paid from earnings not yet collected, and in certain decisions of our courts some years ago it appears that the courts favored this interpretation. This attitude has now changed, however, and several years ago the national banks were required by the Comptroller of the Currency to set up accounts representing "interest earned but uncollected," and "interest collected but not earned." We now find a continually growing number of banks changing to the accrual method of accounting. Another argument against accrual accounting is that it requires the keeping of much more careful records and that the accounting system is somewhat more complicated. It is true that the accruals will be unsatisfactory unless the work is done accurately. This does not seem to be a valid objection to accrual accounting, however, because all bank accounting should be accurate.

The chief arguments in favor of accrual accounting are, first, that it shows day by day just what the bank's earning position is. If there is a tendency toward a decrease in earning power, this is quickly detected, and the reason can be determined. If necessary, a change of policy may be brought about, which, under the cash basis system, might be delayed several months, to the serious detriment of the undivided profits account. The second strong point in favor of an accrual method is that it provides the best means of auditing the bank's income and expenses. Through the accrual records it is determined what the bank's collections

of income and disbursements for expenses should be. If these figures are not realized, that, in itself, is a warning that all may not be well, and the proper auditing system should, and will, determine the reason for the difference, regardless of how well the discrepancy may be hidden. The additional time and work required for the handling of an accrual accounting system are well worth while when the system is properly managed, and the many advantages far outweigh all objections. The accrual method of accounting is approved by the federal income tax authorities, and banks are permitted to file returns based on either method, provided they are consistent in the method that they use.

THE APPLICABILITY OF ACCRUAL ACCOUNTING, AND ITS INSTALLATION

Perhaps many of us have thought of accruals chiefly in connection with our interest received and interest payable accounts, but the picture is incomplete unless all the items possible are put upon the accrual basis. Many banks have therefore taken into account such items as taxes, insurance, salaries, dividends, and, by means of budgets based on previous years' experience, have even included advertising, supplies, and, in fact, practically all income and expenses. Banks that have adopted the various methods of accrual have applied them in numerous ways, and we shall find some of them accruing some items daily, some weekly, and some monthly. It appears that they have thought of accrual, first, from the standpoint of showing a regular flow of income in place of showing a high return of

income for one period and a high rate of expenses for another. They therefore put the daily accrual system into operation on their larger earning assets and interest-bearing liabilities. These, of course, would consist of such items as loans and discounts and time deposits. Other items, such as taxes, might be accrued weekly; still others, such as interest on mortgage notes, bonds, or smaller assets, and Christmas savings deposits and other liabilities might be accrued monthly. In this latter case, the earnings and expenses accrued monthly would approximately offset each other and would therefore not affect the net condition to any great extent. It is without doubt best to make all accruals daily in order to obtain the actual condition of the bank at the close of any day.

The matter of the installation of an accrual system is one that should have the most careful consideration. Those persons in the organization whose work will affect the system or be affected by it, should be made familiar with what is expected of them. If the work of installation is to be done by the bank's own personnel, there must be one or more persons who have familiarized themselves with every phase of the work. If the work is to be supervised by a person from the outside, there should be several in the organization who will learn all that is possible about it, so that it can be carried on properly after it has been installed. It is highly desirable that these people in your own organization should be familiar with basic accounting principles and procedure. In the installation of any system, it is necessary that a high degree of accuracy be obtained and that provision be made for

every possible contingency that may arise.

There are several systems of accrual accounting in use. It is not within the scope of this paper to discuss in detail any of them. It will, of course, be realized that almost any system of procedure will have some merits and some defects. It should be distinctly understood that this paper is not intended to be a selling argument for any particular system.

THE AGGREGATE BASIS METHOD

A copyrighted article in the *Burroughs Clearing House* for June 1927 has summed up the ordinary aggregate basis method in the following paragraph:

"The most common procedure consisted, and still consists, of figuring interest earned but not yet paid on each note to a given date, the total arrived at in this manner being set up as a debit balance in an account entitled 'Interest Earned, Uncollected.' From date of installation a record was kept showing classification of all notes as to their interest rates, new notes being added and paid ones deducted from the total of each rate classification. Daily earnings on each rate were calculated and the sum total debited to the new account on the bank's books and credited to account 'Interest on Loans, Income Account.' Interest collected was credited to account 'Interest Earned, Uncollected.' This latter account reflected from day to day the earned uncollected interest of the bank on its notes.

"Unearned discounts were treated in a similar manner, a credit balance was set up on the books of all discount collected, not yet earned, from

a given date, and additions and deductions were arrived at as outlined in the preceding paragraph."

Extreme care must be used in this method to insure accuracy, because there are many things that may easily throw an accrual out of balance with the true figure, and the differences thus caused may not be detected until an actual inventory is made, perhaps some months later.

Much thought has been given to accrual accounting, so that the errors of the aggregate basis method may be eliminated, and to extend the scope of accrual accounting so that it will more completely cover the earnings and expenses of the bank. It is possible, by improved methods of daily adjustment accrual accounting, to produce for your management a true daily profit and loss statement, and a daily liquidating balance sheet if desired. These same studies have developed the possibilities of an audit control of income and expenses.

A PLEA FOR CAREFUL EXAMINATION OF SYSTEMS

Let us, as practical bank men, examine carefully any system that we may contemplate installing. Let us satisfy ourselves that its operation will accomplish the purpose for which it is intended and the purpose that we desire. Our banks should be, and in most cases are, progressive; but it is only by selecting those methods that have proved themselves that we can proceed with the assurance that is essential to good banking.

To summarize, then, the best thought along the line of daily adjustment accrual accounting is predominantly in its favor. A careful survey should be made in each institu-

tion to determine the best system for that institution. When a system has been installed, it should be operated in the manner prescribed by its sponsors, to the end that the utmost good in results may be obtained. Daily adjustment accrual accounting will cause your books to provide adequate reserves to care for all accrued liabilities and to reflect correctly all earnings not yet collected. By its use, your institution can more readily reach the enviable position of having a healthy, growing surplus and undivided profits account.

Discussion

J. FRED BROWER (Wachovia Bank & Trust Company, Winston-Salem, North Carolina): Mr. Waters, will you please explain more fully the argument against paying dividends from uncollected earnings?

MR. WATTERS: That objection is now rather antiquated, as I think you noted from the paper. There isn't any objection if your basis of accrual is correct. If their sales are worth accruing on in the first place, the accrued earnings are as liquid as the principal amount itself, so you will probably find no further objection along that line.

ROBERT C. COOPER (Northwestern National Bank, Minneapolis): In installing the accrual system in most of the affiliated banks, have you had any trouble? I think there are a great many small banks that have not the accrual system. How far would they go in installing systems in these banks? I think it might not be profitable to install too high a system in these smaller banks. Is there any one here connected with a group who could explain that?

THE CHAIRMAN: I am not connected with a group, but I have observed the system in several places. You will find that the best systems of accrual accounting are such that they will work in a small institution as well as in a large institution; immediately on the acquisition of a new institution as a branch, or one of a group of banks, the very first thing they do is to blanket the situation with whatever system of accrual accounting they use.

MR. COOPER: In our group banks, practically all of them have been established with the accrual system, no matter how small they are.

THE CHAIRMAN: It can be done and, in my opinion, should be done in every bank, regardless of its size.

W. EARL HARRISON (First National Bank, Waco, Texas): Is control of assets and liabilities more important than a control of income?

MR. WATTERS: My opinion in answer to that question would be "no." Misapplication or defalcation of assets or liabilities can be detected by a natural inventory or account, but if a misappropriation of income gets past the closing of your books, it is probably not going to be detected at all, and if it gets past one closing, the same transaction or several of them may be repeated.

PAUL H. HOHMAN (Bank of California, San Francisco): Mr. Waters, how in an accrual system should a note be handled that bears interest from date rather than from maturity when it is customary to discount all notes?

MR. WATTERS: That is, in effect, interest receivable. In the ordinary aggregate basis method, I will give you just the detail of the way we handle it in our own bank.

Let's take an example. We will say a \$1,000 note is running sixty days at 6%. That would give you \$10 interest. As a matter of bookkeeping, under the plan that we use, we would make a memorandum addition to the principal, of the amount of interest for the time, and then we would have to treat that sum as the amount going into the aggregate of loans, accruing on that basis, and deducting the discount, leaving the proceeds the actual face of the note. That throws your true earnings out of line to the extent of the interest on the interest that has been added, and if your accruals are to be kept accurately, you have to take into consideration that amount. That is, as I say, in effect interest receivable, and you have to consider it that way until it is collected.

WILLIAM MILLER (Federal Reserve Bank, New Orleans): How do you handle past due notes in an accrual system?

MR. WATTERS: Probably the most practical way of doing that would be immediately to place that note in non-accruals. A great many banks do. If a note is not paid today, tomorrow it goes into a non-accrual classification and you have there again the item of interest receivable. If we take the example of a note that has been discounted—then on the date due you have taken up all of the discount you had collected, and from then on, it would be interest receivable, if you do not place it in your non-accrual classification.

WM. E. PEASE (Commercial Trust Company of New Britain, New Britain, Connecticut): From a control standpoint, just how do you figure the accruals on your interest

payable, time and demand? Do you find it possible to segregate your demand deposits by sections, for instance, and figure the accruals on each section, or do you find it necessary to refigure the interest as originally figured by the interest clerk?

MR. WATTERS: I don't believe that I quite get your question.

MR. PEASE: For instance, on the demand deposits, possibly you worked from past experience and you obtained a ratio of one per cent or half of one per cent, whatever it might be, on your total demand deposit. Do you find it necessary to recheck the interest as figured by the interest clerk, or can you by your system of accruals maintain a control to make sure that the proper interest has been paid?

MR. WATTERS: I don't know that I have ever seen any place where demand deposits have been put on an accrual basis, because ordinary demand deposits, I believe, are not commonly subject to interest except in a few cases, unless you refer to bank deposits.

MR. PEASE: In some of the smaller towns in Connecticut we have to pay interest on certain accounts in order to get them, and we figure to accrue them each day to maintain a control; I am wondering whether or not it would be safer to accrue each particular section rather than the total in order to get from the basis of experience an absolute control over the interest paid or whether it would be necessary to refigure each one.

MR. WATTERS: It seems to me that you have more or less a local situation. My experience and observation has not covered the point. If there is some one who has had experience in handling demand deposits

upon which you do have to pay interest, I should be glad to hear what that experience is.

MR. PEASE: We use the so-called adaptable system. I don't know whether they make that a general practice in all banks or not.

MR. WATTERS: As I said, I think that is more or less a local situation, and whatever system you use is probably adapted to your local condition.

WILLIAM MCARTHUR (First National Bank and Trust Company, New Haven, Connecticut): Perhaps I can answer that from our experience. We put in our own accrual system. In figuring interest on demand deposits, we pay interest only on balances that run above a thousand dollars. Every account of that kind has an analysis sheet. From our experience over a long period, we can approximate the total amount of interest that will be due monthly, and we set up a certain amount each day to take care of it; at the end of the month when the interest credit goes through, we make an adjustment. We feel that is as near as we can get to it. On the accrual on the savings, we do not pay interest on any deposit made after the third day of the month except during January and July, and then deposits up to the tenth, so that we change our accrual for the first three days of all months except January and July, and then for ten days, and carry it on from there at the same rate.

We do not attempt to make any adjustment for withdrawals, and every six months when the interest is paid, an adjustment is made on the interest for savings accounts. We always expect to come out ahead of the game on savings interest. As a

rule, the deposits will more than bring it down below the amount that you have accrued. We can't get any closer than that.

W. H. LINDSAY (Provident Trust Company, Philadelphia): To answer the gentleman from Connecticut, he asked the question whether there was any system by which accruals would do away with checking the interest. I don't know of any. I have been hunting for one for three or four years. I believe it has to be done a second time.

MR. PEASE: I asked that question because a man criticized me for rechecking all the interest.

THE CHAIRMAN: We expect to treat this subject in more detail another year and are merely trying to hit the high spots. I hope we will be thinking about it in the meantime.

HARRY KAISER (Vliet Street State Bank, Milwaukee): Supposing our bank had \$50,000 of commercial paper at 3%. When we came to sell it two months later, the rate had changed so that there was a loss. In order to keep the accrual correct so that it could be adjusted later on, what would you do with that loss?

E. J. NOVY (Federal Reserve Bank of St. Louis, St. Louis): When you sold, if you suffered a loss, it would not affect the daily earning, but if you sold at a profit, you would credit your miscellaneous profits account or your miscellaneous earnings account. If you suffered a loss, the proper place to show that would be in the miscellaneous debit side of the ledger account. The earnings on it would not be disturbed. If you held the paper to maturity, you would earn on it just as you did on the first day you bought it.

Departmental and Per-Item Cost Accounting

By ALFRED J. BLASCO

COMPTROLLERS' DEPARTMENT OF THE COMMERCE TRUST COMPANY,
KANSAS CITY, MISSOURI

Address before the Denver Departmental Conference

"Departmental and per-item cost accounting is the logical and orderly breaking down of bulk income and expense totals into their component elements." Mr. Blasco stresses the idea that both income and expenses should be distributed, not only among the departments, but also among the divisions of the departments.

In connection with this address on departmental and per-item cost accounting, the author presents detailed charts, showing

1. Plan of expense distribution
2. Activity chart
3. Movement of checks deposited
4. Application of expenses to item activity.

Mr. Blasco is confident that any banker who will provide himself with carefully prepared cost figures and use them intelligently as an aid in the management of his business, will benefit largely.

PRESUMABLY, the term Departmental and Per-Item Cost Accounting is designed to cover a twofold operation: first, the operation of allocating income and expense items by departments or divisions, and the comparison of the one with the other; second, the further allocation of income and expense factors within each department or division, to the end that appropriate evaluation may be made of the most minute single operation or series of operations.

The analysis of departmental or divisional income and expense factors may be performed without consideration of item or unit costs, while unit or item costs may be derived only after painstaking and comprehensive study has been applied to departmen-

tal or divisional operations. In view of this fact, the departmental and divisional distributions are the first to be discussed.

For the purpose of this discussion, it will be considered that a bank department represents a line of major banking activity, such as commercial banking, securities sales, or trusts and estates service, while a bank division represents an operating unit within any bank department.

DEPARTMENTAL AND DIVISIONAL COSTS

Income and expense figures are accumulated by means of control accounts on the bank's general books. While such an accumulation of items

in control accounts is necessary from the operating viewpoint, the total figures are of little value in so far as statistical information is concerned. The items composing the income account and those composing the expense account must be studied, and allocated to the departments which created them. All income and all expenses are to be considered.

ANALYSIS OF INCOME

A bank has income from a number of sources. All income may be divided roughly into two kinds: (1) that which derives from the employment of funds; and (2) that which derives from trading activities and from services rendered.

Let us consider that the bank's commercial banking department has to do solely with the securing of deposits and the employment of funds. Such income, other than that derived from employment of funds, as accrues to the benefit of that department, will, in reality, be in the nature of expense refunds, such as exchange charges, service charges, and the like. Let us further consider that other bank departments are to receive credit only for their trading profits and for fees for services rendered.

This division of income may be challenged in some quarters, since it provides that the commercial banking department is to be credited with income from the bank's capital investment. It provides that the commercial banking department will pay all expenses incurred in the employment of the bank's capital account. In furtherance of the plan, let us say that our first objective is to determine the average gross earning rate from all investments. We feel that

no one is in a position to say just which investments make up the depositors' funds and which the bank's capital, and, further, which investment expenses result from the one as opposed to the other. Having determined the income rate and the investment cost, per thousand dollars of available funds, we then can, if desired, set forth the result of capital employment separate and apart from the commercial banking operation.

In many banks, it is considered that trading and service departments should benefit, on some basis, from the employment of the bank's capital, that some arbitrary, lump-sum income should be credited to them. We believe that such a plan is dangerous and that it confuses operating results. Perhaps we may better express the reasons for such a statement by comparison of a bank bond or securities sales department with some other line of endeavor, say a commercial company, manufacturing shirts and dresses. In order to determine the profit from the shirt department we must credit it with gross income from the sale of shirts, charging against it the cost of shirts, the cost of carrying shirts unsold, and the cost of selling them. The two situations are analogous; neither participates in capital earnings.

Following the plan outlined, income may readily be distributed among department. Following this, income is to be divided within each department to whatever extent seems advisable for application against specific lines of investments: in the case of the banking department, against specific lines of service in the trust and estate department, and against specific classes of securities in the securities sales department. In other

words, each department's income is to be divided among the divisions of the department.

ANALYSIS OF EXPENSES

Expenses fall into three general classifications, to wit:

1. Direct expenses: the base expenses incurred in the actual performance of a specific operation or process
2. Indirect expenses: the general and supervisory expenses incurred in the performance of a number of operations or processes, but chargeable directly thereto
3. Administrative expenses: expenses incurred for the benefit of all departments, operations, and processes, but common to none.

The first two classes, direct and indirect expenses, are to be found in each department and in each division of a department, but it seems advisable to segregate all administrative expenses in a separate classification known as the administrative department. The administrative department has no income. We therefore must either consider that administrative expenses are not subject to distribution and represent simply a deduction from the net earnings of all departments, or we must distribute them among all departments on some arbitrary basis.

Our view is that administrative expenses should be considered purely as a deduction from the net earnings of all departments, as a matter of book-keeping, but that they should be divided on some fair basis among the departments for cost analysis purposes.

In the allocation of expenses, it

should be remembered that the correct separation of the expenses into the three classes results from proper analysis of functions--I mean that the same kinds of expenses (salaries, rents, insurance, traveling, and the like) are common to all, the direct, indirect, and administrative classes. The mission and the nature of each operating division in the bank must be thoroughly understood by the persons making the analysis, and the true meaning of every expenditure must be carefully studied before allocation is made.

Comparison between income and expense is generally made with respect to departments; yet the real meaning of the figures cannot be appreciated until the items are broken down among the divisions of each department. In the original analysis, such divisional allocation should be made, the divisional totals then being accumulated by departments. Let us always remember that, while the department is the functional operating unit, the division is the direct operating unit, and it is with respect to divisional operations that really vital information is needed. As an example, if the commercial banking department should have equal profits for two periods, no questions might be asked, although it is possible that because of higher call loan rates, the investment division produced considerably more income during one period than the other, all of which might have been absorbed by wasteful operating methods in, say, the transit division.

I repeat: departmental cost analysis, to be useful, must be divisional and subject to comparison by divisions.

Form I of the papers placed in your hands is a graphic presentation

of what we have been discussing. You will note the tank at the top. Here all expenses are accumulated. This tank represents the bank's general expense account. We open the tank and the expenses flow to the major departments, one of which is administrative. From each department they flow to the divisions. The divisions of the commercial banking department have been drawn in as an example. They are labeled "direct" and "indirect." The tank now is empty, and each division of each department now is burdened with expenses applicable to its operations. To this point, indirect divisions remain separate and apart from direct divisions, and the administrative department stands forth as one of the major departments. Here departmental cost accounting ends. The elimination of indirect divisions through the process of loading them on to direct divisions, the allocation of divisional expenses against items handled, and the loading of the base item costs with appropriate administrative burden—these constitute the mission of per-item cost analysis.

PER-ITEM COSTS

Costs of items and/or units of operation make up the expenses of each department and division. We have considered that the present subject contemplates the costs of deposit accounts, and further discussion will be restricted to the matter of the bank's commercial banking activities.

The expenses of the commercial banking department, other than the cost of investing its own capital, result purely from the bank's dealings with its depositors. The bank pays its depositors for the use of their

money in two ways: by direct payment of interest, and by services rendered. All the expenses of the department, then, are chargeable against depositors, with the exception of an appropriate amount of conversion expense, representing the transformation of capital investment into earning assets. If we consider the bank's capital account as an additional deposit, all expenses are chargeable against deposit accounts.

Referring to Form I before mentioned, it is seen that direct expenses and indirect expenses have not been combined. Before proceeding with analyses tending toward item costs, we must eliminate indirect expenses by loading them on to direct expenses in some fair manner. Considerable study should be given the method used. If we use "direct cost" methods, we simply allocate to each "direct division" a portion of "indirect division" expense in the ratio which each "direct division's" expenses bear to the total of all "direct division" expenses. Let us say that this is the method to be used in the present instance. When it has been done, the direct operating division expenses include the expense of supervision and general service. With the understanding that the direct operating expenses in each division have been loaded with indirect expenses, let us proceed with the analysis of cost factors entering a customer's account. All commercial banking department expenses may be said to fall into these four general classes:

1. Interest paid depositors
2. The maintenance of depositors' accounts, exclusive of activity
3. Item activity expenses
4. Conversion operation expenses

INTEREST PAID DEPOSITORS

This is a known item of expense and is readily applicable to the appropriate deposit account.

MAINTENANCE EXPENSES

This covers the cost of carrying an account on the active books, exclusive of any activity in the account. It covers the cost of a statement sheet each month, a ledger sheet occasionally, and the imprinting of the customer's name on each. It covers the cost of handling each sheet each day and proving the balances two or three times each week. Finally, it covers the cost of preparing the statement for the customer, together with delivery to him at the close of each month. The maintenance expense, of course, is restricted to the book-keeping division.

ITEM ACTIVITY EXPENSES

All the expenses of many of the divisions, and portions of the expense accounts of others are chargeable to item activity. This is indicated at the bottom of Form I.

CONVERSION EXPENSES

The expenses of the credit and discount departments, together with an appropriate amount of the "indirect" expense, measured by the time lending and investment officers spend in lending and investing funds, constitutes the conversion expense.

WORKING OUT ITEM ACTIVITY COSTS

Having determined just what di-

visional expenses are chargeable to each of the four main classes of deposit costs, we now must attack the task of determining just how many operations were performed or items handled for the period covered by the expense allocation. We also must, within each division, determine the relative unit values of the various types of operations performed or items handled.

Form II is a typical form of "activity chart," in this case, that of the "blotter" or "general distributing division." It shows, for the period of a month, the items of the various classes handled, where they originated, and to which division they were charged.

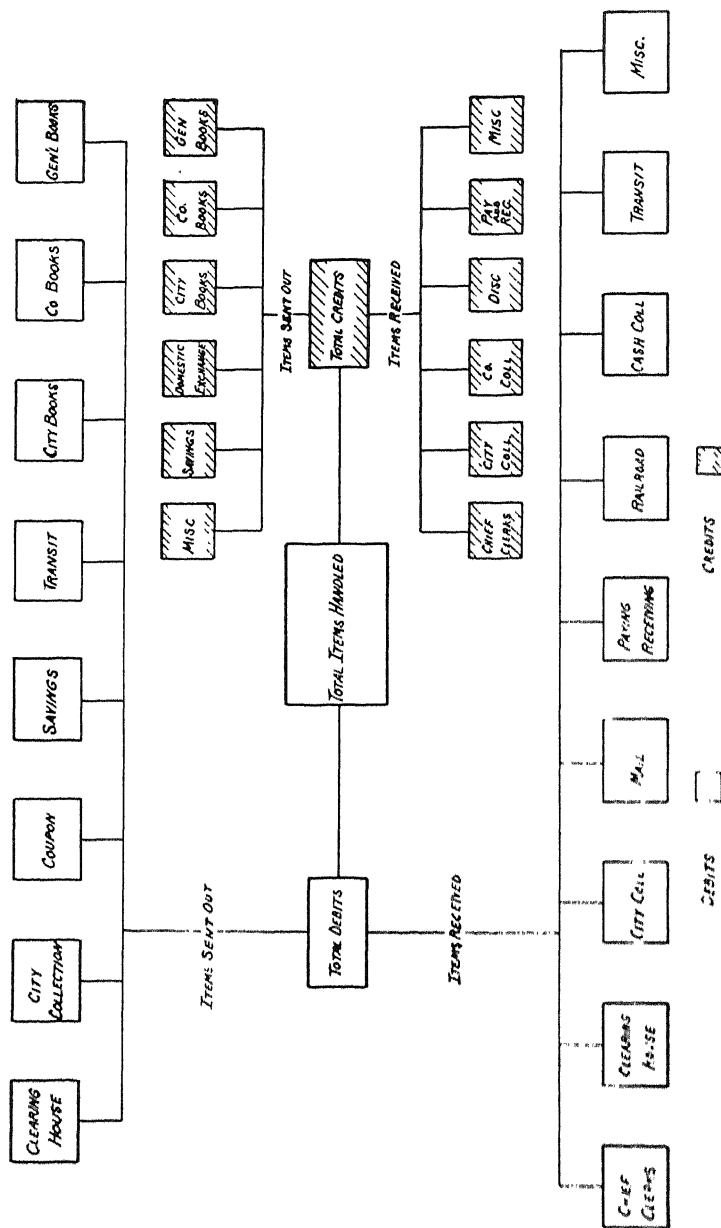
Form III is a chart of the movement of items accepted for deposit, a typical deposit. It will be noted that while this division handles a transit or clearings check once, a check on ourselves was handled by this division twice. Therefore, each check on us has twice the unit value, in so far as this department is concerned, as a check payable elsewhere. Of course, this element must be considered, and unit values must be determined. After unit values have been applied, the total units of effort expended on each class of items is derived. The percentage of total units in each class to all units represents the percentage of divisional expense chargeable to each class.

Form IV shows the working out of item costs from the point where percentages have been derived.

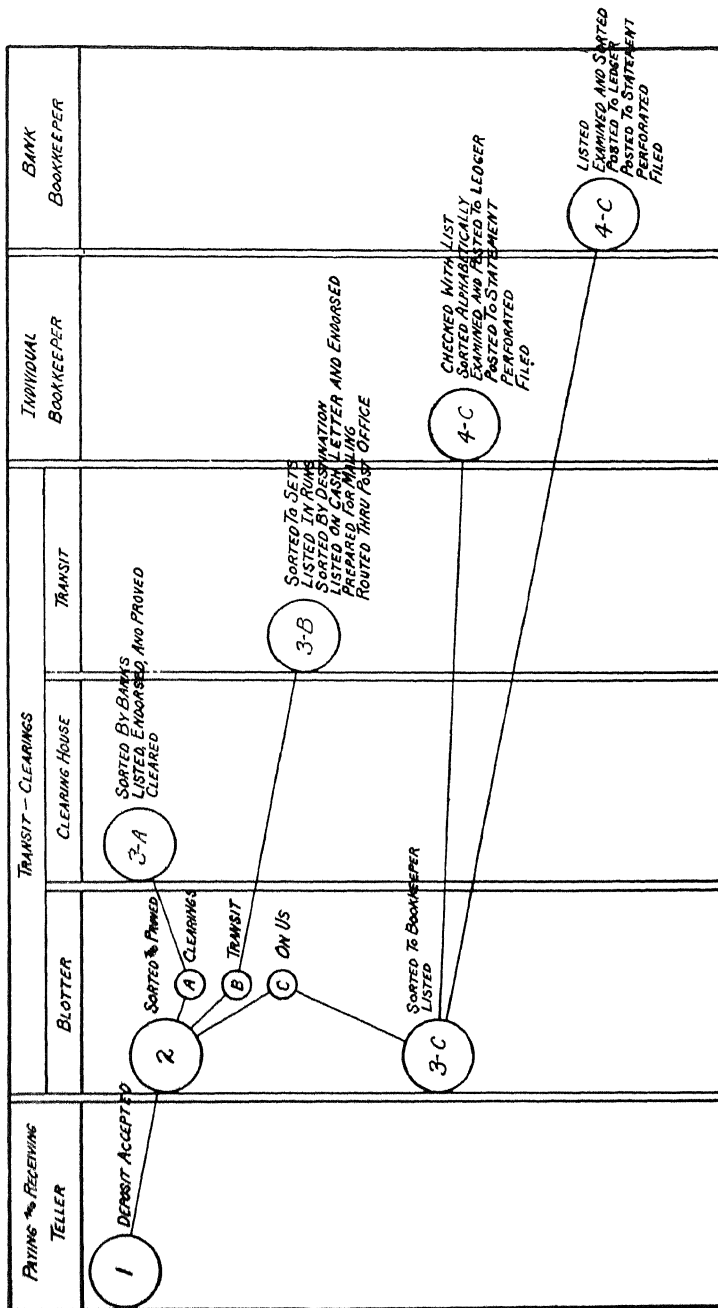
WORKING OUT CONVERSION COSTS

Conversion costs have reference not so much to units of investments

FORM II
ACTIVITY CHART
BLOTTER DIVISION
SHOWING ITEMS HANDLED
DURING THE MONTH OF



FORM III
MOVEMENT OF CHECKS DEPOSITED



made as to volume of dollars invested. Having arrived at the total conversion expenses for a period, we must determine to what funds the expense is applicable. The process follows:

Add:		
Capital	000,000	
Surplus	000,000	
Undivided profits	000,000	
Borrowed money		
(if any).....	000,000	
Average daily		
deposits	000,000	0,000,000
<hr/>		
Deduct:		
Float	000,000	
Reserve (legal		
plus cash)...	000,000	000,000
<hr/>		
Net funds for in-		
vestment		000,000

The cost is applied as so much per thousand dollars of net funds per month.

ADMINISTRATIVE EXPENSES ELIMINATED

The administrative department expenses apply alike to all bank operations. As previously stated, they may be considered as a deduction from net earnings, or they may be considered as a part of operating costs. We ourselves favor the latter method. The plan I am about to describe is arbitrary. I know of no plan of administrative distribution which is not arbitrary. Let us determine the ratio the total of the administrative department's expenses bears to all other bank expenses after elimination of interest paid and commissions paid. Suppose this rate is 18%. Then, if we load every bank item cost or operation cost with 18% of itself, administrative expense is eliminated, arbitrarily but effectively.

ACCOUNT ANALYSIS

In applying costs to accounts, we must determine first the net funds for investment provided by each account. We must apply against such funds our average income rate, found by dividing all "investment income" for a period by "total funds for investment." From this total of income are deducted the various expenses as hereinbefore outlined.

A typical analysis is shown on opposite page.

Summarizing, we find that departmental and per-item cost accounting is the logical and orderly breaking down of bulk income and expense totals into their component elements. It is the job of making a large number of small problems out of one tremendously big one, and providing the means for the solution of these small problems. While the present subject does not contemplate the application of cost figures, still all must recognize that cost figures are valuable or dangerous according to the use made of them. Any banker who will provide himself with carefully prepared cost figures and use them intelligently as an aid in the management of his business, will, without doubt, benefit largely.

Discussion

W. E. DREW (The First National Bank, San Jose, California): Mr. Blasco, in your opinion, of what value is information for cost analysis?

MR. BLASCO: It is valuable because it discloses the factors which enter into the profit of each class of activity. Through the tabulation of activities which is so necessary in cost

analysis, very interesting information is secured, which can be used to balance the work of individuals and departments, thus eliminating peak loads.

In knowing the methods of handling items and visualizing them on paper, you can focus attention on sig-

Blasco, where do you draw the line as to the items which properly enter the administration account?

MR. BLASCO: I believe that any item of expense not susceptible of distribution to any department or division is properly administrative.

KEITH W. CLAGUE (San Diego

ANALYSIS OF A DEMAND DEPOSIT ACCOUNT

(Estimated average figures used)

Average daily book balance

Less average daily total of uncollected items

Net balance

Less 11% reserve

Net loanable balance

Income

Earnings on balance @ $5\frac{1}{2}\%$

Exchange charged

Total income

Expense

Direct disbursement

Interest paid on balance @ %

Exchange absorbed

Activity costs

Drafts on us.....@ \$.025 per item

Credits@ .08 per item

Transit items@ .015 per item

Clearing house items....@ .01 per item

City messenger items....@ .15 per item

Country collections@ .15 per item

Coupon collections@ .15 per item

Other costs

Investment cost and lending cost

(\$.20 per \$1,000 net lendable funds per month)

Maintenance costs.....\$.50

Total expense

Profit

Loss

nificant facts which may result in eliminating irrelevant detail in handling. Incidentally, you have at hand an intensive control of expenses in the comparison of item cost between periods.

OLE TORVEND (Bank of New-
man, Patterson, California): Mr.

Trust & Savings Bank, San Diego): In applying cost analysis to deposit accounts, upon what factors would you base the profit desired?

MR. BLASCO: You have hit upon a question that is difficult to answer. Manufacturing concerns base their profit upon cost. Why

should not banks do the same? It is my belief that the profit factor should be based upon the cost of the account, but should be expressed in dollar value of deposit.

By that I mean, reducing the cost of the account to a balance which, at say 6%, would cover the cost. The basis for your desired profit then, would be on the balance equivalent. This is fair, for the profit is commensurate with the services rendered.

RAULEY BANNER (First National Bank, Fort Worth, Texas): Mr. Blasco, do you make an analysis of your accounts and then charge the customer with the net loss, if any?

MR. BLASCO: In some cases we do, but remember, the application of cost figures is very dangerous. I believe the account should be analyzed over a certain period of time. Bear in mind that you have a seasonal business on your books. Then, before you actually charge that customer, call him in and have a heart-to-heart talk with him. He is a business man just as you are. He is in business for profit, and so are you. You will find him fair, and the result will be a satisfactory balance, or a charge.

MR. BANNER: On chain stores, grocery stores, for instances, we have a very large amount of debits and checks and they usually keep a very small balance. We have had trouble with grocery stores like that. They send the funds in to the head office. We have been trying to get them to increase their balances, but have had no cooperation.

MR. BLASCO: We have had the same trouble, and I think that every banker has had trouble with chain store accounts. In analyzing the chain store account we figure the cost

of handling their deposits. For instance, we know of one account that takes the time of two men every morning. In our bank we figure that it takes 66 $\frac{2}{3}$ % of a man's salary in addition to the salary itself to keep him operating. We figure the total time required in handling the deposits and apply this loaded hour of expense along with the other item costs. We have used this basis in charging a few of such accounts.

WILLIAM MCARTHUR (The First National Bank and Trust Company, New Haven): In arriving at the per item of cost, how do you count the number of items? Is that one item only in going all the way through the various departments, or is it an item each time it is handled?

MR. BLASCO: As explained, we have segregated the divisional expenses. Each particular division, then, must be considered and given credit for every item it handles. For instance, the blotter division handles all classes of items. Its expenses are distributed to the various classes of items handled, after considering their respective unit values. After determining the class cost, we divide by the number of items in that class, and the result is your per-item cost.

GLENN E. BRUMBAUGH (St. Joseph Stock Yards Bank, St. Joseph, Missouri): When you find out you lose so much money, you charge the account. I don't think it is quite fair to charge just the amount that you lose. Do you add a profit on to that actual loss?

MR. BLASCO: Wherever we can, we try to. Bank cost analysis is relatively new and people are not educated sufficiently to understand what the banks are trying to accom

plish in this regard. If you can iron out satisfactorily the large accounts that are costing you a great deal of money, you will have had a good start. Call them in and have a little talk with them and see if you can't get them to increase their balances or pay you a fair rate for your services which will include a reasonable profit.

J. FRED BROWER (Wachovia Bank & Trust Company, Winston-Salem, North Carolina): We have put them on a very profitable basis in that we have seen our customers and explained to them that we are losing on their accounts. They have allowed us to charge their account with this loss or have increased their balances more than enough to take care of the loss so that we can make a profit on it.

RONALD H. FREITAG (The City Bank, Milwaukee): In charging a customer for handling his account, do you charge him on an equitable basis or an arbitrary figure? The banks may be operating under a different expense, and consequently the cost of handling the account would be different at each bank.

MR. BLASCO: Volume will materially affect your item cost. We have found that the item cost in our locality will vary quite a little. In our bank our facilities provide for extensive transit operations. As a result we have been able to handle transit items at considerably lower cost than any bank that I know of in our vicinity. The banks should get together and arrive at a fair charge in the application to the small account. In the cost analysis of the large account, the individual bank should use its own cost figures.

WILFORD GRADEL (Northwest-

ern Trust Company, St. Louis): This refers to departmental cost. Do you consider it practical and is it the general custom to include interest on investment as an element of cost? For instance, you have \$50,000 in your safe deposit department. Do you consider interest on the \$50,000 as an element of cost of the safe deposit department? If you didn't have the safe deposit department, you could invest \$50,000.

MR. BLASCO: I think there is no question but that we should consider interest on investment. For instance, we have our own building. The building department charges our bank with rent and the commercial department then charges the building department with the interest on its investment in the building. It is an element of cost from the standpoint of the building division.

SIDNEY T. TAYLOR (Walker Brothers Bankers, Salt Lake City, Utah): Would you consider it advisable for five or six banks of various sizes to set up a figure that could be used by all banks on cost accounting for internal checks, out of town checks, and so on? Would you suggest that they all get together and use the same figure? In our particular locality a certain representative came through and found out that almost every bank had a different figure for every sort of item used, and they laid their cards on the table and asked how they arrived at it. Every bank had a different answer. Would you suggest that the member banks in a city get together and use a unified figure?

MR. BLASCO: I believe the banks should get together and arrive at some unified cost and apply these at least to the smaller account. Of

course, competition is keen among banks; and if one bank can handle a large account more reasonably than another, it will be its way of bidding for business. It behooves the other banks to find out why their costs are higher and attempt to remedy the situation. However, it is believed that as far as the small account is concerned, a uniform set of costs should be used.

THE CHAIRMAN: I find as a rule that cooperation on all those items among banks in the same city

or in the same section will be much to the benefit of all those banks that are cooperating.

MR. BLASCO: Along that line, too, if your item costs vary a great deal, check back to see just what the actual result is. In other words, it might be because the volume that you handle is less than the other bank's, or it might be because of the method that you actually take in handling the item. I think you can trace back and see just what the actual trouble is. It shouldn't vary a great deal.

Budgetary Control

By E. J. Novy

AUDITOR OF THE FEDERAL RESERVE BANK OF ST. LOUIS, ST. LOUIS, MISSOURI

Address before the Denver Departmental Conference

The budget is a buffer, that breaks all the shocks incident to bank management. It is a searchlight, casting its rays back over the past and forward into the future, and thereby safeguarding the pathway of the present. It is a fire alarm, warning the bank of threatening conflagration. It is a yardstick, by means of which the bank can measure its own growth or decline. And always it is elastic, stretching to meet the needs of the large institution and shrinking in adaptation to the small.

If you have never visualized a budget so romantically, read Mr. Novy's article, and see whether you have not missed something of the significance of this invaluable adjunct of bank management.

MUCH has been said both for and against the budget. It is referred to frequently as a "new business fad." However, when we consider that the architect plans his building, and the engineer surveys and charts his prospective road or grade, we can readily see the significance and wisdom of the budget, which is an economic measure.

This principle applies not only to the individual or partnership, but to the corporation as well. Without a limit or control it is an easy matter to become indulgent to business vices, such as carelessness, indifference, over-purchasing, and overexpansion. This danger is minimized by the installation of a budget, carefully planned, by means of which a proper portion of the income is applied to necessary overhead, cost of operation, supplies, and ordinary and extraordinary expenses.

There is a certain confidence and pride felt by the bank executives or the board of directors when they

know just about what the cost of the day's operations will amount to; that to turn the key in the door of the bank to begin a day's business means a cost of such and such an amount. There is a greater pride and confidence in also knowing that the inevitable expenses are properly and comfortably covered by earnings sufficiently large to meet them; and that the dividends on capital stock, and other expenses, are properly provided for.

SOLVING PROBLEMS BY THE BUDGET

The installation of a budget system is the essential factor in helping to solve these problems. The income of an institution reflects, by comparison with established ratios, what the relative average expense should be. The budget is an instrument that can guide you to safety, no matter what the obstacle. Competent budget control can provide the ratio cost, and

expense per thousand, of deposits. With proper departmental expense records under the budget plan, the institution operating service departments is safer, because the cost is controlled. If the expense of operation is not within reason, the department may become a burden to operate and cause the bank no end of trouble. The system is tantamount to having your index finger on all departments.

Should you not care to operate on the departmental method, the budget plan will "provide almost the same measure of safety by the control of expenditures. The system may be made simple or elaborate as occasion may require. It may be made to cover income as well as expenses and expenditures. Successful manufacturing enterprises which are competently informed as to their costs have achieved their success largely through information ascertained from the budget and from proper records.

Many of us may feel that our establishment is too small to bother with a budget; others, in the larger bank, may feel that they cannot be burdened with the additional work; but to the careful, thinking executive, comparative figures, averages, and ratios over specific periods are significant and helpful. I should suggest, then, that, regardless of the size of the bank or institution, you take as your basis the facts and figures of the experience of former years, say three to five years' average, or, if you prefer, just the previous year, provided it was a normal year. Set up the figures as a starting point, according to each classification of income or earnings, and outgo (expenses or expenditures), using an independent record, such as a trial balance, columnal book, or analysis sheet, placing thereon the ten-

tative budget figures in round amounts, each item according to account classification, and including therein also all reserves and contingencies.

METHODS OF ARRANGING THE BUDGET

The system may be handled in many ways: the amounts may be allotted monthly for the income and expenditures, or they may be allotted on an annual total basis. If the monthly plan is adopted, then the actual figures of the income and expenditures for the month may be applied alongside the budgetary figures, and the comparisons will bring forcibly to your attention the results, which will either prove you to be a reliable prophet or show wherein you have erred.

It is also practicable to have the record in cumulative form. This is convenient when bringing forward the cumulative figures from month to month from the trial balance, to be compared then with the budgetary amount.

Another method, which is also desirable, may be adopted by setting up the annual or gross amounts of the various items of income and expenses anticipated, by the appropriation method. This plan should be handled through a separate ledger, crediting the income appropriation and charging the various income accounts with their anticipated earnings, and charging the total expenses appropriated and crediting the various expense accounts with their anticipated expenditures.

At the end of each month there are charged against the income of the various items the amounts actually earned—the total of the actual earn-

ings credited to the appropriation account. The actual expenses are then credited against the various expense items, their total being charged to the appropriation account. In this manner the various income or expense ap-

less like municipal or government procedure, it is a very practical method, for in the event that an appropriation is being exhausted quickly it is brought to official attention for further appropriation, whereupon it is

TABLE "A"

EARNINGS FOR THE MONTH OF.....193				
	Earnings for Month	Budget for Month	Accrued Earnings	Accrued Budget
On discounts				
Purchased bills and acceptances.....				
Loans:				
Secured				
Unsecured				
United States securities.....				
Municipal bonds				
Miscellaneous bonds				
Stocks				
Income from rents, and so forth.....				
Interest received on balances in banks.....				
" " " call loans				
Safe deposit vault rentals.....				
Foreign department, fees and charges.....				
Commission on bills and securities bought and sold				
Exchange and collection charges.....				
Trust department revenue				
Service charges				
All other earnings.....				
Total earnings				

propriation accounts constantly show the remaining balances, which are significant to all interested executives as showing the status of various income or expense accounts.

While this last method is more or

looked into as to the cause of its rapid depletion.

This system of budgetary control is effective in arousing the executives to the falling off in revenue, which would necessarily call for immediate

TABLE "B"

CURRENT EXPENSES FOR THE MONTH OF.....193				
	Expenses for Month	Budget for Month	Accrued Expenses	Accrued Budget
Advertising				
Salaries:				
Officers				
Clerical staff				
All other employees.....				
Extra help				
Overtime and supper money.				
Traveling Expenses:				
Officers				
Clerks				
Directors				
Fees:				
Directors'				
Legal				
Insurance:				
Fire, tornado, theft, liability, and so forth.....				
On currency and security shipments.				
Taxes				
Light, heat, and power.....				
Repairs and alterations.....				
Rent of premises.....				
Office and other supplies.....				
Printing and stationery.....				
Telephone and telegraph.....				
Postage and express charges				
Miscellaneous:				
Rental of equipment.....				
Postage meter, Post Office box.....				
Repairs and maintenance of equipment.....				
Vault inspection, time service, and so forth.....				
Laundry, cleaning, water supply, and miscellaneous banking house expense.....				
Licenses and permits—automobile, chauffeur's, ele- vator, and so forth.....				
Taxi fare and carfare.....				
Credit reports, periodicals, news service, and so forth				
Clearing house membership, fees, and so forth.....				
Medical service and examinations.....				
Entertainment of bankers.....				
Employees' dinners				
Membership dues and donations:				
American Bankers Association.....				
State and other bankers' associations.....				
Credit Men's Associations.....				
Chambers of commerce.....				
American Acceptance Council.....				
American Institute of Banking.....				
All other expenses.....				
Total expenses				

MEMORANDUM: Accrued dividends
 Depreciation
 Other reserves

TABLE "C"

8 H 895 2M 5 27

.....DEPARTMENT. UNIT NO.....

FOR THE PERIOD.. ..

Item	Actual	Budget Proportion	Amount Increase Decrease	Remarks
Salaries.....				
Extra help.....				
Supper money.....				
Traveling expenses				
Stationery and supplies.....				
Telephone and telegraph.....				
Stenographic.....				
Miscellaneous.....				
TOTAL.....				

NOTE: If necessary, add additional list of details of items not shown above.
Show details of the amount budgeted for salaries on the back of this form.

curtailment of expenses or expenditure connected with a particular department or division. Many an executive feels that this procedure cannot be applied practically to his case or problem, and that comparisons of averages, monthly or cumulative, are just as safe; but the appropriation method brings to his attention any extraordinary condition arising, any sudden turn in affairs beyond his control.

When the budget control is set up, the amounts shown in the tentative record have a comparable value. In this way, if you have used figures of an average period of years, an increase or decrease as compared with the previous average experiences immediately signals, by reason of these differences, that the source of revenue must be scrutinized for a reason, the same principle applying to expense.

A SPECIMEN FORM

To supply a specimen form for review, a facsimile of the statements described above is set up for your survey, this so-called "card of accounts" covering fully the method implied. The smaller institutions can eliminate the accounts which do not apply to their cases; the larger institutions, I feel certain, will find the classification adequate for their requirements. It can be made elastic and extended to include also special reserves and depreciation. The amount of detail is a matter of choice with the individual handling such matters.

Budgetary control can also be broken down for departmental purposes by the further analysis of the income and expenses as applied to the various departments. It can be applied, too, to the assets and liabilities,

according to the various groupings appearing in the balance sheet. The prudent banker changes the class of investments as the liability demands, and at all times aims to keep his position (primary and secondary) reasonably liquid. The character of his obligations governs this position; consequently the budget in this respect is looked upon with considerable favor for this control as well as for that of revenue.

I trust that I have set forth clearly and without complication what the plan means and how it is accomplished. In my opinion the institution striving for success cannot afford to be without it.

We use every means for the safeguarding and protection of assets, such as insurance, fidelity bond, signal systems, guards, and so forth. Is it not reasonable, then, to safeguard and protect the income, and to control the expenses?

Discussion

SAMUEL J. STORY (Mercantile Commerce Bank & Trust Company, St. Louis): Does the budget provide for flexibility to care for the expanding of the contract in a business?

MR. NOVY: It does, in this way: in the contract I call attention to the matter of ratios. For instance, you know what is your top figure of income. It may be discounts; it may be earnings upon your stated investments. Those, as I pointed out to you, you handle on a ratio basis and any decrease or increase instantly notifies you of a corresponding increase or decrease which should be made or should be looked for in the expense against whatever revenue you anticipate. For instance, we will say

that you anticipated average discounts to the extent of \$120,000 a month. That figure slumps to \$90,000 a month. In fact, we have just such a period at the present time. You know that if that is twenty-five per cent of your income and it slips down to fifteen, it means you have got to look to the expense of the upkeep of that department. Percentage is the short method. When you look at the ratio and note 2, $2\frac{1}{2}$, 3, or $3\frac{1}{2}$, it is significant, and you don't need to look at the amount of dollars; but when you look at the ratio increase or decrease, you instantly know that you have got to cast your eye at the lower part of the sheet and look after the expense pertinent to that department.

FRED N. SCULLY (Moxham National Bank, Johnstown, Pennsylvania): Does budget control depend upon a clean-cut separation of the various types of deposits and then their subsequent investment by departmentalization?

MR. NOVY: It does, absolutely. As I pointed out in the paper, the prudent banker watches what his demands are. The prudent banker will keep his eagle eye on the deposits. That is the nature of the liability he has got to watch. For instance, we will say that a banker has a world of municipal deposits. He knows that he is going to hold them for three months or for four months. He may be able to put those funds into a fixed investment which will give him an absolutely substantial return, but he knows that within four months, those funds are going to be withdrawn. Consequently, he has to anticipate something at the time of the withdrawal of these funds. For a while the prudent banker went out, and looked for as long a time paper as

his deposit block showed him he could conservatively invest, and he didn't bother about call money because there was no more demand for call money; I know any amount of money that was wired on East and was immediately returned, because they had no place to put it. So there was a loss of earnings on those funds. The prudent banker who had only a small portion of that and had these other funds invested at a desirable earning rate was sitting pretty. He wasn't worrying about any unemployed funds at all. Consequently, what is in this deposit block, properly analyzed, indicates what he can do on the other side, provided he knows where to increase the funds and into what character of investment he should put them, considering at all times the primary and secondary investment portion of funds.

J. FRED BROWER (Wachovia Bank & Trust Company, Winston-Salem, North Carolina): Would you suggest a budgetary committee or a finance committee of officers to put in the budget and then control that budget to make it elastic?

MR. NOVY: My idea along that line depends largely upon the organization. In some institutions, particularly the larger institutions, we have an executive committee. They are the men who have charge of the operations of the bank. In the small institutions they may have an investment committee or a committee that passes upon what they shall do with their funds. My idea in that respect is this: have your accounting department, your comptroller, and your auditor constitute this budgetary committee and submit to your executive committee certain recommendations. I think that the joint committees ought

to handle that, for this reason: they are familiar with what is going to happen to the funds at various times of the year. Remember the fact that no business in the world is as sympathetic to conditions as banking. It has a seasonal demand. Consequently, the investment committee and the executive committee know what is going on in that respect, and you as the budget committee can make this recommendation. You have here anticipated earnings of \$250,000 by reason of investment. If they know what they are about, they will tell you you are off on this about \$50,000. Then you instantly glance down and see whether there shouldn't be some curtailment in the joint direct and indirect expense of that particular division of the business. For instance, if you don't know what is going on in your service department and you haven't your anticipations, you can lose more money in three months than you can earn on this side of the house in six months.

ALFRED J. BLASCO (Commerce Trust Company, Kansas City, Missouri): Do you consider or rather consult the department head in setting up your budget?

MR. NOVY: The department head should be handed an estimated sheet or an anticipated sheet. He should be given a figure of what it costs to operate his department. I mean those who have the cost figures at their fingers' ends. They should be given this sheet and asked to make up what they think will be the ordinary expenses for their departments for either the month, the six months, or the year, as the case may be, on whichever basis you determine to handle it. Then when you merge these, you see whether that proves to be the experience of the

period that you previously analyzed. If that is in excess, you look into the departments to ascertain why and for what reason they anticipate these certain increases, or decreases, as the case may be. Then you either cut them, or you make up your budget accordingly; then you confront your committee with the fact that it is going to cost \$20,000 more this year or \$30,000 more this year to operate this institution than it did last.

Then they immediately turn to the department head that made up the expense budget and say, "How do you intend to overcome this increase?" Then he goes on to say that he has this prospect. He anticipates certain underwritings. He anticipates certain sales or certain revenue from sales that will take care of that increase. Normally there is an increase from year to year in institutions that are on their toes. It is fair for him to figure what ratio of increase he anticipates and fair for you to consider it in the preparation of this budget. But at the end of either the month or the quarter, the six months or the nine months or the year, he is held to strict accountability for the business which that amount of money is supposed to produce.

JACK GORMLEY (First Seattle Dexter Horton National Bank, Seattle): Do you think it is advisable for merged institutions to have a budget, and what method would you suggest?

MR. NOVY: I personally think it is a very wonderful thing for a merged institution, because through that merger, there will be a natural curtailment. I think the merged institution that doesn't do it is running wild.

MR. GORMLEY: On what basis would you start?

MR. NOVY: On their combined experience for a normal previous period. For instance, a bank may have two accounts in a city where it has been doing business. When the banks merge, that instantly reduces those two accounts to one account. That reflects a curtailment in the expense of two accounts as against one.

In a merger they have got to take up a certain amount of slack which they will have to overcome in new business, or it is a case of elimination. They can take a committee from each side, a committee of men who know the bank and who know the operations. I think they can save a great deal of money in operation.

Ratio Analysis and Control of Resources and Liabilities

By W. E. PAUL

VICE PRESIDENT AND TREASURER OF THE FRATES COMPANY, TULSA,
OKLAHOMA

Address before the Denver Departmental Conference

Mr. Paul believes that the proper interpretation of financial statements by bank analysis is just as applicable and useful to the banking institution as to the commercial organization.

He makes a complete analysis of the balance sheet of an industrial corporation according to eight major practical ratios: (1) current assets to current liabilities; (2) quick assets to current liabilities; (3) net worth to debt; (4) permanent capital to fixed assets; (5) sales to receivables; (6) sales to inventory; (7) sales to fixed assets; (8) sales to total assets.

Using this analysis to illustrate the use of ratios in the interpretation of financial statements, Mr. Paul then submits and explains in full detail the following thirteen ratios, which might act as a guide in the management and control of banking institutions: (1) deposits to quick assets, 2 to 1; (2) deposits to time deposits, 8 to 1; (3) demand deposits to cash on hand, 20 to 1; (4) deposits to cash and exchange, 4 to 1; (5) deposits to capital and surplus, 10 to 1; (6) deposits to loans and discounts, $1\frac{2}{3}$ to 1; (7) loans and discounts to first mortgage real estate loans, 10 to 1; (8) loans and discounts to capital loans, 10 to 1; (9) loans and discounts to slow loans, 20 to 1; (10) loans and discounts to single industry loans, 3 to 1; (11) loans and discounts to investments, $2\frac{1}{2}$ to 1; (12) capital and surplus to bank premises, 2 to 1; (13) total assets to capital, surplus, and undivided profits, 10 to 1.

I AM thoroughly convinced that a proper understanding of the value of financial ratios in the interpretation of financial statements generally would lead to a far more accurate conclusion with respect to those financial statements so analyzed, and would result in bases for the formulation of sounder policies of management and control.

Inasmuch as I am not a banker, I shall first approach this subject from the viewpoint of the commercial organization.

OBJECTIVES OF ACCOUNTING

Each one of you is familiar with the equipment and details of some accounting department. You have seen or perhaps are in charge of numerous devices which are designed to expedite the recording chronologically of financial transactions. You are aware of the vast amount of work being done in your banking institutions which could be classified more or less specifically as bookkeeping or accounting. Some of you

have a picture of the entire accounting department in your mind and some of you perhaps are familiar only with one or more branches of it. What is the object of this vast and highly organized machinery which is constantly operated in every business enterprise? What is the final result of the systematic accumulation of financial data? In every case the answer to the above questions is, that at the end of the day, the month, the year, or some other convenient accounting period, it will be possible to establish the financial position of the organization and to determine and measure its progress. In other words, all bookkeeping and accounting systems, regardless of whether they consist of a few books of original and permanent entry, or whether they include all of the modern facilities for recording and posting financial transactions, are designed to produce at the end of the fiscal period a balance sheet and a statement of profit and loss, together with supporting exhibits and schedules.

Great stress is laid on the necessity for preparing financial statements promptly. Every effort is made to compile the figures on working paper and to have those figures typed and assembled in the form of a report. This is as it should be. It is highly desirable to encourage promptness in the preparation of financial statements, and in modern business organizations the routine of bookkeeping and statement preparation has been so well organized that it is possible to prepare financial reports shortly after the close of the particular accounting period under review.

However, the point at which most of us stop, namely, the completion of the financial statements, is the place

where those of us who are charged with the responsibility of compiling the facts and figures relative to our business, should begin. A financial report, regardless of the fact that it is accurately and neatly typed and contains all the necessary statements, is of comparatively little value unless it is accompanied by an interpretation of the figures submitted, so that the real significance is clear to those who are charged with the responsibility of management and organization and who are entitled to know the facts.

Mr. H. L. Gantt, in a lecture delivered at Yale University, said:

"We have no right morally to decide as a matter of opinion that which can be determined as a matter of fact. If we allow ourselves to be governed by opinion where it is possible to obtain facts we shall lose in our competition with those who base their actions on facts."

INTERPRETATION OF FINANCIAL STATEMENTS

Interpretation of financial statements, then, is the vital work which should be performed by the man in charge of the accounting department, by whatever title he may be known, and demanded by the man who is responsible for the success or failure of the business.

How do we proceed to interpret a financial statement? There are many rules of theory which may be applied in a practical way to the interpretation of financial statements, but perhaps the most practical and useful method is the computation of ratios between related items and groups of items found on the balance sheet, and between such item or items and gross income.

The use of financial ratios in commercial organizations has gained favor during the last few years, and a great many articles and books have been written covering the subject more or less adequately. I have given this matter considerable thought since the profession of accountancy has become actively interested in producing ratios other than the current ratio, and I believe the interest which has been taken in this subject has been more beneficial to the profession of accountancy and to the business organizations which this profession serves than any other development of recent years. Great stress is now laid on the value of finding out just what a financial statement means, and whether this interpretation is made by the computation of ratios or in some other practical way, the result is to use the financial statements which have been so carefully prepared, in some practical and helpful way, instead of filing them and making no further reference to them after they have been prepared.

Each authority on the subject of financial ratios calculates various ratios which he contends are significant and vital, but a close study of the subject as a whole, at least from the commercial point of view, probably limits the number of practical ratios to eight, which are listed as follows:

1. Current assets to current liabilities
2. Quick assets to current liabilities
3. Net worth to debt
4. Permanent capital to fixed assets
5. Sales to receivables
6. Sales to inventory
7. Sales to fixed assets
8. Sales to total assets.

DEFINITIONS OF RATIOS

Let us briefly review each ratio in

order that we may understand it.

The current ratio is a broad measure of the adequacy of working capital, based on a comparison of current assets available for the liquidation of current liabilities.

The quick ratio states the relationship between the more definitely and directly debt paying assets, namely, cash and receivables, and the amount of current liabilities.

The ratio of net worth to debt compares the investment of proprietorship with that of creditors.

The ratio of permanent capital (contributions of proprietorship plus long time obligations) to fixed assets describes the allocation of funds used by the business to permanent uses and to current uses, respectively.

The ratio of sales to receivables will result in a statement of the average age of all customers' accounts.

The ratio of sales to inventory, while it does not state the exact turnover rate, will indicate in a measure, movement and salability of inventories.

The ratio of sales to fixed assets indicates either the active and effective use of the permanent facilities, or an overinvestment in such facilities.

The ratio of sales to total assets is another test which indicates the extent to which the total asset fund employed is productive of sales.

Until quite recently, the examination of financial statements was made principally to determine the amount of credit which might be extended. Various methods of analyzing statements were developed, and among these was the use of financial ratios. This last method has proved itself to be a very satisfactory one from the credit man's viewpoint, provided he does not place absolute reliance upon

the indications which he finds. The use of ratios in balance sheet interpretation should be supplemented by an investigation of points of strength and weakness which are indicated by the ratios, and the conclusion should not be arrived at without making such supplementary investigation.

No well organized business would extend credit to a new customer without first calling for his financial statements and analyzing them thoroughly.

IMPORTANCE OF RATIO ANALYSIS

If, by the use of ratio analysis of financial statements, the credit man is able to come to a conclusion as to the probability that the particular organization will survive and be able to liquidate its indebtedness, is it not reasonable to assume that the same conclusions could be reached regarding the financial soundness and profit-making ability of any organization whose statements were submitted for analysis? If the credit men in the various commercial organizations and banking institutions examine customers' statements before extending credit, would it not be a logical thing for the comptrollers of these various commercial and banking organizations to examine their own statements as carefully as they would the statements of their customers? The fact that the practice of analyzing statements developed by reason of the necessity of credit extension, does not preclude the examination of statements for the purpose of determining and using the facts to be disclosed.

ANALYSIS OF AN INDIVIDUAL BALANCE SHEET

Let us take the balance sheet of

the Industrial Manufacturing Corporation, which appears on the blackboard before you, and compute the various ratios heretofore indicated so that we may come to an intelligent conclusion as to the financial condition of this company.

CURRENT RATIO

Let us first compute the current ratio. This is found by dividing the current assets of \$122,833.86 by the current liabilities of \$51,463.91, which will give us a quotient of 2.39, which means that this company has \$2.39 of current assets available for the payment of each dollar which it owes. For many years a current ratio of 2 to 1 has been considered satisfactory, and, while it is dangerous to attempt to arrive at standard average ratios, if we have \$2 in current assets for every \$1 of current liabilities, everything else being equal, the current ratio indicates a sufficient working capital.

QUICK ASSETS TO CURRENT LIABILITIES

Let us next compare the quick assets with the current liabilities. In order to arrive at this ratio, we divide the quick assets, consisting of cash, notes receivable, and accounts receivable, totaling \$47,287.87 by \$51,463.91, the current liabilities, and we arrive at a quotient of .92, which means that we have 92c in cash, or receivables which should in the normal course of business be converted into cash in a short time, available for the payment of each dollar of current liabilities. A great many authorities state that if cash and accounts receivable are equal to current

INDUSTRIAL MANUFACTURING CORPORATION

BALANCE SHEET¹

AS OF DECEMBER 31, 1929

<u>Assets</u>	
Cash	\$11,667.22
Accounts receivable	27,345.65
Notes receivable	8,275.00
Total quick assets	\$47,287.87
Inventories	74,399.70
Prepaid expenses	1,146.29
Total current assets	\$122,833.86
Fixed assets (less depreciation reserves)	
Furniture and fixtures	\$4,371.25
Trucks and autos	9,388.43
Machinery	78,399.18
Buildings	110,638.54
Land	21,706.00
Total fixed assets	224,503.40
Deferred charges	3,419.37
Total assets	\$350,756.63
<u>Liabilities and Capital</u>	
Accrued expenses	\$649.15
Accounts payable	20,814.76
Notes payable	30,000.00
Total current liabilities	\$51,463.91
Mortgages payable	40,000.00
Total liabilities	\$91,463.91
Capital stock	\$225,000.00
Surplus	34,292.72
Total proprietorship capital	259,292.72
Total liabilities and capital	\$350,756.63
Sales for year	\$376,859.42

¹ Acknowledgment is made to Myron M. Strain, author of Industrial Balance Sheets, for above statement and comments thereon.

liabilities a satisfactory condition is indicated. The comparison of quick assets with current liabilities is sometimes referred to as the "acid test," and a ratio of 1 to 1 under normal circumstances is satisfactory.

NET WORTH TO TOTAL LIABILITIES

Let us compare the net worth of the proprietorship to the total liabilities. This net worth to debt ratio is found by dividing the capital stock and surplus, amounting to \$259,-292.72, by the total indebtedness of \$91,463.91, the resulting quotient being 2.84, which means that the proprietorship has contributed originally and has permitted profits to accumulate to the extent of \$2.84 for every dollar which has been advanced by creditors. This ratio expresses the proportion between the capital owned by the proprietors and the capital loaned by creditors. The principle involved in the calculation of this ratio is that the fund of assets used by the company in its operations, consists of its own net worth and advances made to it more or less temporarily by creditors. The ratio existing between the proprietorship capital and money borrowed measures the debt pressure. The higher this ratio, the easier the debt pressure. As this ratio becomes lower, the company is subject to the criticism of being "top-heavy with debt." While I want again to caution you against the danger of accepting standards for any of the financial ratios, we might under most conditions accept a net worth to debt ratio of $2\frac{1}{2}$ to 1 as being a proportion which would indicate a substantial investment by the proprietorship as against the advances

of creditors. In this case we have 2.84 to 1, which provides an adequate margin of safety for the creditors.

PERMANENT CAPITAL TO FIXED ASSETS

Let us compare the permanent capital with fixed assets. This ratio is determined by dividing the net worth of the proprietorship plus the funded debt, or a total of \$299,-292.72, by the fixed assets, amounting to \$224,503.40. This gives us a quotient of 1.31, which means that the proprietorship has contributed and borrowed on a long time basis, sufficient funds to cover the entire investment in plant and other fixed assets, and have available for working capital 31c out of each dollar so contributed or borrowed. Under ordinary conditions a ratio of $1\frac{1}{2}$ to 1 would indicate adequate permanent financing and in our case we show a ratio of 1.31 to 1, which is not far below this theoretical standard.

SALES TO RECEIVABLES

In applying our test of sales to receivables, we do not arrive at a quotient as we have done heretofore, but we state our receivables on a time basis, so that the result of our comparison will be stated as the number of days of apparent age of all receivables. We divide the total sales by 365 to determine the sales per day, and then we divide the total receivables by the average daily sales, which gives us a quotient of 34, indicating that the average of each receivable is 34 days. In the ordinary business, accounts receivable which did not average more than 45 days

would be considered as collectable, in the absence of any knowledge as to the probable uncollectability of specific accounts.

SALES TO INVENTORIES

The ratio of sales to inventories is valuable in that it is an indicator of activity. In computing this ratio we divide the sales by the inventory, which gives us a quotient of 5.06. This quotient does not indicate the ordinary turnover, as the term is used, since turnover is determined by dividing the cost of goods sold by the average inventory. However, it would not be logical to assume in this instance that the inventory was unusually slow, even though we are not aware of the percentage of gross profit included in the sales figure of \$376,859.42.

SALES TO FIXED ASSETS

In computing the ratio of sales to fixed assets, we divide the sales figure of \$376,859.42 by the total of the fixed assets, amounting to \$224,503.40, which gives us a ratio of 1.68. This indicates that for every dollar which had been invested in fixed assets, sales were made to the extent of \$1.68. The fixed assets of any business are obviously held for the ultimate purpose of making possible, and furthering, sales. It is, therefore, reasonable to assume that the volume of sales is a fair measure of the success of the management in accomplishing this purpose, and that the ratio between investment in fixed assets and sales is a significant one. In this case we would probably be justified in the conclusion that the company was not guilty

of overinvestment in plant. Some authorities state that for every dollar invested in fixed assets, sales to the extent of \$1.50 should be received. If this standard is reliable, our ratio of 1.68 to 1 is more than we could ordinarily expect.

SALES TO TOTAL ASSETS

The comparison of sales to total assets is a broader test than that of sales to fixed assets. Here again we assume that the entire fund of assets employed by any business should bear a certain proportion and should contribute to sales volume. In computing this last ratio we divide the sales of \$376,859.42 by the total assets amounting to \$350,756.63, which results in a quotient of 1.07. This indicates that for every dollar used in the business, sales have been made of \$1.07. This last ratio supports the conclusions of the ratio of sales to fixed assets.

INTERPRETATION OF THE RATIOS

Reviewing the eight ratios just computed, the current position as shown by the current ratio would be above the "average" by 39c. This conclusion, however, is somewhat weakened by the fact that inventories, which make up well over half of them, turn somewhat slowly, probably about once every three months, and certainly less than five times per year, and also by the fact that cash and receivables are 8c less than enough to cover current debt. Neither of these circumstances, however, is serious enough in extent to suggest any notable weakness, and the receivables appear to be current and highly liquid.

The organization appears to be well financed, having an investment of \$2.84 per \$1 of advances by creditors, which allows a substantial margin of safety. It also has enough of its own capital, plus long term borrowings, to cover all its permanent assets, with 31c of every dollar left over for working capital.

Comparison of sales with fixed and total assets discloses no alarming conditions, the sales of the company being sufficient to suggest the active and effective use of its facilities.

RATIOS IMPORTANT TO BANKS AS WELL AS TO INDUSTRIAL CORPORATIONS

The analysis which we have just made of the industrial corporation, illustrates the use of ratios in the interpretation of financial statements. It is information of this kind which should be submitted to the management by those of us who are engaged in the accumulation and presentation of financial facts. No more important work can be done by the comptroller of a bank or commercial enterprise than to calculate those ratios which are pertinent to his particular organization, and advise the management of the points of strength and weakness which have been indicated to him by the ratios he has produced. If it is possible for him to do so, he should compare these ratios with the same ratios calculated for prior years, and also with ratios computed on the basis of figures found in statements of other business organizations, especially those most closely related to his own.

The banker is largely guided in coming to a conclusion on the request of his customer for a loan by the re-

sults of his examination of the customer's statement. In this examination the ratio of current assets to current liabilities is given the most careful consideration, and in many cases some of the other ratios we have reviewed are calculated and considered. However, this same banker probably neglects to study the statement of his own bank and the ratios to be computed from the figures shown thereon.

The merchant or manufacturer uses a certain fund of assets in his business, with the idea that he will increase that fund by manufacturing or selling merchandise at a figure greater than the cost of that merchandise to him. The banker also uses a fund of assets with the same ultimate purpose in view. If it is profitable to the merchant or the manufacturer to compute and consider the indications of ratios which he finds by comparing related items on his financial statements, then it must also follow that there are certain inherent relationships existing between items and groups of items to be found on the financial statements of banking institutions. While it may be true that ratios for banking institutions have not been so carefully considered as the ratios which we have discussed, nevertheless these ratios do exist and should be used.

RATIOS FOR THE MANAGEMENT AND CONTROL OF BANKING INSTITUTIONS

I shall submit for your consideration a few ratios which I believe might act as a guide in the management and control of banking institutions. These ratios are applicable to banks in the larger cities and would not be indicative of strength or weakness in

STATEMENTS OF THREE REPRESENTATIVE BANKS

	<u>Bank "A"</u>	<u>Bank "B"</u>	<u>Bank "C"</u>
ASSETS			
Cash and sight exchange.	\$17,000,000.00	\$4,500,000.00	\$20,878,000.00
United States Government securities.	3,500,000.00		8,837,000.00
Marketable bonds and securities.	4,177,000.00	7,700,000.00	11,520,000.00
TOTAL QUICK ASSETS.	\$24,677,000.00	\$12,200,000.00	\$41,235,000.00
Loans and discounts.	31,000,000.00	8,700,000.00	33,195,000.00
Overdrafts.	2,000.00	8,000.00	14,000.00
Bank premises.	950,000.00	1,125,000.00	275,000.00
Redemption fund.	30,000.00		3,750.00
Stock Federal Reserve bank.	90,000.00	60,000.00	163,500.00
TOTAL ASSETS.	<u>\$56,749,000.00</u>	<u>\$22,093,000.00</u>	<u>\$74,886,250.00</u>
LIABILITIES AND CAPITAL			
Deposits.	\$51,166,400.00	\$19,769,000.00	\$64,350,000.00
Circulation.	582,600.00		75,000.00
Bills payable and rediscounts.			3,673,500.00
Capital.	\$2,000,000.00	\$1,000,000.00	\$5,000,000.00
Surplus.	1,000,000.00	1,000,000.00	1,787,750.00
Undivided profits.	2,000,000.00	324,000.00	6,787,750.00
TOTAL LIABILITIES AND CAPITAL.	<u>\$56,749,000.00</u>	<u>\$22,093,000.00</u>	<u>\$74,886,250.00</u>

country banks or in loan and trust companies. I have arrived at these ratios after having studied the subject as carefully as the time allowed to me would permit and after having conferred with national bank examiners and some of the leading members of the profession of accountancy, and after having read everything which I could find heretofore written on the subject. In order to test the ratios which I have computed, I obtained many bank statements and compared the ratios computed from these figures with the ratios which I am submitting for your consideration. In making this comparison, I found that in many cases the ratios computed on the figures contained in the published bank statements were not in agreement with the standard which I had set, and in order to test further the value of my ratios I made careful inquiry in order to determine those banks in the tenth Federal Reserve district which were considered the soundest and best managed institutions. By a process of elimination, I finally selected three banks in this district which have been conducted on a sound and profitable basis for forty or fifty years, and which have the reputation of having capable and progressive management. I shall present the statements of these banks to you, together with the ratios computed on the basis of those figures, as compared with my standard ratios.

The financial statements of the three banks referred to and the ratios computed thereon are shown on the blackboard now before you. The figures on the bank statements have been changed so that only round amounts are shown, but the individual items and the totals are practically identical with the published state-

ments. As you will note from the blackboard, the ratios listed thereon are as follows:

1. Deposits to quick assets...	2-1
2. Deposits to time deposits...	8-1
3. Demand deposits to cash on hand	20-1
4. Deposits to cash and exchange	4-1
5. Deposits to capital and surplus	10-1
6. Deposits to loans and discounts	1 $\frac{2}{3}$ -1
7. Loans and discounts to first mortgage real estate loans.	10-1
8. Loans and discounts to capital loans	10-1
9. Loans and discounts to slow loans	20-1
10. Loans and discounts to single industry loans....	3-1
11. Loans and discounts to investments	2 $\frac{1}{2}$ -1
12. Capital and surplus to bank premises	2-1
13. Total assets to capital, surplus, and undivided profits.	10-1

DEPOSITS TO QUICK ASSETS 2 TO 1

In analyzing any bank statement, our first thought should be to ascertain the degree of solvency of the bank from the statement we are reviewing, and the protection offered to the depositor.

Under the caption "quick assets" I have included cash and sight exchange, and government and other marketable bonds and securities. There are other assets which are more or less current, such as bankers' acceptances, good commercial paper, customers' paper eligible for rediscount with the Federal Reserve bank, and so forth, but these have not been included in the ratio computed.

The ratio of 2 to 1 suggested above, under normal conditions,

would seem to provide sufficient margin, especially if the ratio of total deposits to time deposits is not abnormal.

A decrease in this ratio indicates a greater degree of conservatism.

DEPOSITS TO TIME DEPOSITS 8 TO 1

If we accept the ratio of 8 to 1 as the probable average in national banks located in larger cities, this ratio, when computed with reference to a specific bank, will provide in a measure an explanation of the difference between the expense of operation of that bank and of another bank whose ratio is not the same. For instance, two banks may have practically the same amount of assets; yet one may have a much larger percentage of demand or commercial deposits, while the other may have a greater percentage of time or savings deposits. The bank with a majority of demand deposits will require more employees and accounting facilities than the bank with a minority of demand deposits; however, the latter bank will show a much larger total of interest paid on deposits.

There is a point between the two extremes of having all demand deposits or having all time deposits, at which any bank may operate most successfully. I believe that this position would be reflected by a ratio of 8 to 1.

DEMAND DEPOSITS TO CASH ON HAND 20 TO 1

This ratio is probably low for city banks, especially for those banks which are located in the same town with, or only a short distance from, a

Federal Reserve bank, since these banks may in a very short time obtain from the Federal Reserve bank whatever currency may be required. However, a ratio of 20 to 1 would be very conservative for the banks just referred to and would probably be sufficient for country banks located at greater distances from the local Federal Reserve bank.

DEPOSITS TO CASH AND EXCHANGE 4 TO 1

The ratio of deposits to total cash and sight exchange depends to a very large extent upon the ratio of demand to time deposits. If there is a large proportion of the former, the amount of cash to be carried is, of course, larger than if the proportion of time deposits is greater; but, as a general rule, if the total deposits are four times as great as the cash items, the proportion is probably well balanced. In applying this ratio to a particular bank, however, there are two other controlling factors which should be considered: first, that it is necessary to carry enough cash to maintain the legal reserve and to provide for business requirements, to the extent that unforeseen withdrawals will not embarrass the bank by forcing it to liquidate some of its investments with possible losses due to depreciation in the market; second, that an excess of the amount normally required would mean that there are idle funds in the bank which are not working. If we study this ratio we shall find that it is a matter of considerable importance for the individual bank to establish its own ratio based on its experience, so that it can maintain that ratio or have a logical explanation for increases or decreases from year to year.

DEPOSITS TO CAPITAL AND SURPLUS 10 TO 1

In the analysis of commercial statements, we compare the investment of proprietors with the investment of creditors, and we find that if the fund of assets being used by the business has been supplied by the proprietorship and the creditors in the ratio of 2 to 1, sound financing is usually indicated. The deposits of a bank represent the amount of the public's investment in the institution. The capital, surplus, and undivided profits represent the proprietorship's investment. These two items have a relationship which should be measured, in order to determine the most desirable proportion between the two classes which have supplied the fund of assets.

If the deposits increase, then earnings, and consequently the dividend rate, should increase. However, if there is no corresponding increase in capital, the margin of protection to the stockholders decreases as the ratio of deposits to capital increases. It would seem to follow, therefore, that in order to insure conservative growth, a proportionate increase in capital should follow an increase in deposits.

DEPOSITS TO LOANS AND DISCOUNTS $1\frac{2}{3}$ TO 1

The deposits of a bank are used primarily to take care of the borrowing needs of the customers and to cover generally all short time investments. The degree of solvency of the bank is dependent very largely upon the liquidity of the loans and discounts.

A ratio of deposits to loans and discounts of $1\frac{2}{3}$ to 1 would permit

the bank to lend 60% of its deposits with an ample margin of safety. This ratio could be allowed to run even lower if the loans and discounts were of such character that they would be acceptable by the Federal Reserve bank for rediscount.

LOANS AND DISCOUNTS TO FIRST MORTGAGE REAL ESTATE LOANS 10 TO 1

Because of the absolute requirement that loans and discounts be maintained in as liquid a condition as is consistent with the requirements of the customer's needs, and the necessity for maintaining the institution in a high degree of solvency, loans which are not eligible for rediscount by the Federal Reserve bank or other loans of a similar nature must be reduced to a minimum.

Banks which handle high grade first mortgage real estate loans probably should not permit such loans to exceed 10% of the total loans and discounts. A ratio lower than 10 to 1 would indicate an unfavorable tendency, especially if the ratio of loans and discounts to capital loans and to slow loans were also below the standards.

LOANS AND DISCOUNTS TO CAPITAL LOANS 10 TO 1

It is not the function of a commercial bank to supply deficiencies in the capital structure of its customers. This is the business of the mortgage and investment banking house. However, a certain amount of capital financing is inevitable. When a commercial bank makes a loan to supply capital for one of its customers, it in a measure becomes a partner in the

business of that customer and must assume a risk far out of proportion to the return it may receive for making that loan. From another viewpoint, when a commercial bank makes such a capital loan, it is encouraging its customer to start or expand his business on a financial plan which is manifestly unsound.

From my experience in the field of public accountancy, I know that the customer is not justified, except in very rare cases, in requesting the bank to lend him money to supply an inadequacy of working capital, which should be contributed by the proprietorship, except on a temporary basis.

A ratio of loans and discounts to capital loans of 10 to 1 would in my judgment be the lowest ratio which could be maintained with safety.

LOANS AND DISCOUNTS TO SLOW LOANS 20 TO 1

In conversation with a former national bank examiner, Mr. O. A. Griffey, a few days ago, I asked him whether it was not true that a bank which had been in business over a long period of time would inevitably accumulate, depending on its management, a certain number of slow or questionable loans. His answer was that every bank, probably, regardless of its management, is likely to make loans which will eventually result in losses, or at least prove difficult of collection. He said that loans of this character might be expected to equal 5%, but that when the figure reached 10%, in his opinion the management should be "checked and double checked."

However, this ratio would be of little value to a bank in wheat-

cotton-raising country, for instance, during the marketing period.

LOANS AND DISCOUNTS TO SINGLE INDUSTRY LOANS 3 TO 1

In the commercial bank management booklet No. 1 issued by the Clearinghouse Section of the American Bankers Association, I find the following paragraph:

"Granting excessive loans to a single interest is, of course, another practice to be avoided. The mere legality of the subterfuge of making separate loans to officers and directors in addition to those loans made to the business, itself, constitutes no justification for them. A state superintendent of banks recently said that in almost every bank that failed he found such excessive loans. Every banker should realize the extent to which he can properly expand his risk in any given direction. Beyond this he should not go under any circumstances, no matter if the credit be as prime as any on his books."

The above paragraph applies to the lending of money to a single business concern, and the statements made regarding the dangers of that practice are also applicable to loans made to a single industry.

While no useful ratio could be calculated comparing the total loans and discounts to loans made to an individual business concern or its officers, a ratio of 3 to 1 representing the comparison between total loans and discounts and loans made to a single industry might be approximately accurate and useful as a guide.

LOANS AND DISCOUNTS TO INVESTMENTS 2½ TO 1

This comparison is valuable in that it indicates the proportion exist-

ing between the two major earning assets of the bank. However, the ratio may vary widely, depending upon the total of cash and sight ex-

The more liquid the item of loans and discounts, the higher this ratio might go without disturbing the degree of solvency.

RATIOS—CITY BANKS

	<i>Standard</i>	<i>Bank "A"</i>	<i>Bank "B"</i>	<i>Bank "C"</i>	<i>Average</i>
Deposits to quick assets...	2-1	2+-1	1.6-1	1.5-1	1.7-1
Deposits to time deposits....	8-1	.....	.....	.....
Demand deposits to cash on hand.....	20-1	....	.....	.....
Deposits to cash and exchange	4-1	3-1	4.4-1	3-1	3.4-1
Deposits to capital and surplus	10-1	17-1	9.8-1	9.5-1	12-1
Deposits to loans and discounts	1.66-1	1.66-1	2.33-1	2-1	2-1
Loans and discounts to first mortgage real estate loans.	10-1	.....	.....	.....
Loans and discounts to capital loans.....	10-1	.....	.....	.....
Loans and discounts to slow loans.....	20-1	.....	.....	.....
Loans and discounts to single industry loans.....	3-1	.....	.....	.....
Loans and discounts to investments.....	2.5-1	4+-1	1.1-1	1.6-1	2.2-1
Capital and surplus to bank premises.....	2-1	3+-1	2-1	Rented	2.5-1
Total assets to capital, surplus, and undivided profits.	10-1	11+-1	10-1	11-1	10.6-1

change, which, in considering the degree of solvency of the bank, would be the equivalent of readily marketable securities.

CAPITAL AND SURPLUS TO BANK PREMISES 2 TO 1

In a commercial organization the

ratio of permanent capital to fixed assets should ordinarily be about $1\frac{1}{2}$ to 1, which means, as stated heretofore, that a company is on a reasonably sound financial basis if the proprietorship interest, plus the long time obligations, supplies all the money needed for the plant and equipment, and leaves available a part of such capital for current use.

A banking institution does not ordinarily require the investment in fixed assets that a manufacturing concern, for instance, would require, although it is a general practice to provide banking facilities on a more or less elaborate scale. I believe that if the bank owns its premises its investment in such premises should not be more than one-half its capital and surplus.

TOTAL ASSETS TO CAPITAL, SURPLUS, AND UNDIVIDED PROFITS 10 TO 1

If the ratios of deposits to loans and discounts, deposits to capital and surplus, and capital and surplus to bank premises, in the individual institution, compare favorably with the standard ratios which have been submitted, a ratio of approximately 10 to 1 of total assets to capital, surplus, and undivided profits, will be found to exist. If this ratio varies materially, the indication would be that one or more of the three ratios mentioned above was out of line.

This ratio indicates the equity of the proprietorship in the total asset fund and is an important indicator of whether the stockholders or the depositors own the bank.

Ratios of gross and net earnings to various items and groups of items on the balance sheet could be cal-

culated to advantage, but, fundamentally, any unfavorable indications which might be shown by ratios comparing income with balance sheet items would indicate defects in the ratios already discussed. If the assets and liabilities on the balance sheet do not bear the right proportion to each other, the operations of the bank will not be profitable, and the solvency of the bank itself will be in jeopardy.

I have, therefore, confined this paper to the so-called internal ratios. If these ratios indicate proper allocation of the total fund of assets and a satisfactory relationship between creditors and stockholders, the bank will fail to prosper only in the event of heavy unforeseen losses or unjustifiable disbursements of funds, such as excessive officers' salaries or declaration of dividends to an extent not warranted.

Discussion

GLENN E. BRUMBAUGH (St. Joseph Stock Yards Bank, St. Joseph, Missouri): I should like to inquire how the standard ratios would stack up in a smaller bank.

MR. PAUL: I tested them out and they don't stack up very well. In a business where you receive pay before you render the service, as in a theatre, you need very little working capital. You could have a one to one ratio, or even less. You do not have to carry accounts and inventories.

Let us take the piano business. I understand that the Chickering Piano Company stores wood for twenty-five years before it is used. It takes a long time to make a piano and then that piano is sent out to some dealer

who sells it on the instalment basis; between the time the tree is cut and the time the final instalment is paid, it may be thirty years. We may say it would take a year and a half or two years between the time of the starting of manufacture on a particular piano and the time the last instalment is paid. There is a period of two years, instead of the immediate return of handing your money over the counter and buying a ticket and walking into the theatre.

So that any current or quick ratio that would be recommended as a standard or average in the case of the manufacture of pianos or similar articles would not always be applicable in the case of a theatre or similar business. So, as I say, these ratios are not very well borne out when they are applied to a small bank. However, there is a set of ratios; somebody knows about them; somebody will compute them eventually, just as we have done in commercial organizations. They will be used sooner or later more extensively in the banking business. It is bound to come.

CARL W. HUMMER (American Exchange Bank, Canton, Ohio): I had anticipated that you would discuss in greater detail the income and expense ratios, or did you purposely leave this out of your paper?

MR. PAUL: If the fund of assets which the bank is employing is properly distributed, and if the relationship between those who have advanced money to the bank (the creditor) and the proprietor is a proper relationship, the income and expenses will take care of themselves, except for unforeseen and unwarranted expenses. I have a better answer, however. Use that budget system for income and expense and use

a proper set of ratios. The ratios we have discussed may not be the ones. Use a proper set of ratios to measure your fluctuations, the increases and decreases in your asset and liability classifications, and you will be surprised how that profit figure will increase. It is bound to.

PAUL H. HOHMAN (Bank of California, San Francisco): It seems to me that the ratio of capital and surplus to bank premises would increase as the bank prospers. I am just recalling our bank. It seems to me our ratio would be about eight to one. If your bank prospers, your surplus is going up; your bank premises are going down.

MR. PAUL: This ratio compares capital and surplus, only, to bank premises; the capital originally invested and the surplus which you hold, appropriated surplus. I did not include undivided profits. It is true that the ratio would increase if you withheld your profit from distribution to the stockholders and built up the proprietorship interest. Of course the ratio would increase unless you felt that your prosperity entitled you to build another bank building, as sometimes happens.

WILLIAM MCARTHUR (First National Bank and Trust Company, New Haven, Connecticut): Mr. Paul, you stated that the smaller banks didn't stack up very well to these ratios. In a good many cases, it is the smaller banks that have gone under, and doesn't that tend to bear out the fact that the reason for their not stacking up is that they are not as well managed?

MR. PAUL: It is more difficult to run a corner grocery store than it is to run a large department store. It is more difficult to run a small busi-

ness than it is a highly organized business. The personal element enters into that small bank just as it enters into a small business, and of course we set up a yardstick by which we are going to measure our future operations; then somebody's cousin comes in or a nephew or a friend and makes a loan which should

not be made. I think, however, it is very largely caused by the more or less impersonal attitude that a large bank maintains which will assist it in maintaining percentages and budgets and ratios and put it in a more advantageous position than the smaller institution. I think you are quite right in your conclusion.

Valuation of Bank Stock in Consolidations

By CHRISTIAN DJORUP, C. P. A.

CHRISTIAN DJORUP & COMPANY, NEW YORK, NEW YORK

Address before the Denver Departmental Conference

Mr. Djourup discusses in full detail the following items, which must have careful consideration in the merging of banks:

1. Comparing banks on the same basis as to resources and liabilities, and as to earnings and expenses, considering items shown in only one of the two banks
2. Valuation of resources
3. Valuation of liabilities
4. Analysis of earnings and expenses
5. Valuation of good will
6. Market value of bank stock.

DURING the last few years, branch banking, chain banking, and group banking have developed to a large extent, and, particularly since the enactment of the McFadden Bill, on February 25, 1927, branch banking has increased considerably by means of consolidations.

Interesting articles on this subject and statistical information are contained in the December 1929 and April 1930 issues of the Federal Reserve Bulletin. The Digest of State Laws Relating to Branch Banking, appearing in the April number of the Bulletin, shows the reason for the development of group banking.

Whether branches are acquired or control of the capital stock of a bank is obtained for other reasons, a value must be placed upon the stock which is transferred from one ownership to

another, and there are no fixed rules as to such valuation.

The value will vary with the reason for the consolidation, merger, or absorption and will depend to a large extent upon the trading ability of buyer and seller and the necessity of such transaction.

Two successful banks may become merged to reduce overhead expenses, to form a more powerful institution, to increase the borrowing facilities that can be granted to large customers, to obtain the services of an outstanding leader in the banking world for the combined organization, and for many other reasons. To effect the merger, the consent of the stockholders is necessary. Usually control of the majority of the stock of one bank is in the hands of or obtained by one individual or a group, and the price for large blocks of stock paid to obtain control may be much above or con-

siderably below the real value of the stock. The ratio of exchange of shares of one bank for those of another may also be subject to conditions outside of book value and good will.

When a weaker bank is absorbed by a stronger institution, this ratio depends upon whether the public's or the stockholder's confidence has been affected on account of severe losses in certain departments, or a run on the bank, or a large defalcation, or the failure of the management to show progress and success. The distrust or the dissatisfaction will be expressed in the ratio of exchange of stock.

When a branch or branches are desired by a bank, it may exchange stock at a ratio favorable to the institution operating such branches, irrespective of the intrinsic value of such stock.

Sometimes a very large holder of the stock of a bank wishes to change his activities or to retire, and he may sell his holdings to a controlling factor of another bank much above or far below the real value, with the result that the exchange of shares may be at a ratio different from the basis warranted by existing conditions.

I will confine myself to the valuation of all stock of both institutions in the hands of stockholders, who wish to arrive at a fair basis for the exchange of stock or the payment of cash to the shareholders of the selling group, based upon assets and liabilities and the earning power of the two banks.

COMPARING BANKS ON SAME BASIS

An easy way out of all problems would be a rule of thumb: taking the

book value and adding a fixed percentage of deposits for good will and dividing the sum total by the number of shares outstanding. This would be a fair basis, however, only if the difference between book and true value happened to be about the same percentage in both institutions and if the deposits of both banks were in the same ratio to "capital funds."

Before arriving at the value of the capital funds, the resources and liabilities of both institutions should be compared, and those appearing in both balance sheets should be treated in the same manner to ascertain the true, market, or fair value, as the case may be. There will remain items among the resources and liabilities particular to one institution only, as, for instance, a foreign exchange department in one bank, a large amount of mortgage loans in the other.

The principles applied in arriving at fair value for like items should also be closely adhered to in valuing special items, not in both banks.

"Earnings and expenses" should also be classified and compared to arrive at the value of good will, and due consideration must be given to non-recurring earnings and expenses and to those applicable to one institution only.

Each institution should be examined by the other, and committees should be formed with executives and directors of both banks as members. Accountants or bank examiners can be used to advantage, and, according to the size of the transactions involved, one firm will be used for both banks, or the regular auditors of one bank will examine the other, and possibly a third firm or some specialist will be engaged to inspect or supervise the work of both and act as arbiter.

Sometimes it may be for the best interests of the stockholders of one bank to form a liquidation committee and to liquidate certain assets on behalf of the stockholders, when difference of opinion exists as to the value of those assets and it is desired to avoid sacrifice sales.

Appraisal companies or reputable appraisers should also be used to assist the committees in arriving at values where the book values are out of proportion to market or true values.

VALUATION OF RESOURCES

1. Cash on hand, in Federal Reserve bank, and due from banks and bankers

If the cash items are in order, the book value will be the true value. Where "due from foreign banks and bankers," representing foreign currency deposits, is included, it will be necessary to ascertain the market value of such deposits after their correctness has been established by reconciling to statements received from foreign correspondents.

2. United States Government securities

The market value should be taken on the same basis, bid price, mean between bid and asked, or last sale.

3. Public securities

The same procedure should be used as in the case of United States Government securities.

4. Other securities

These should be segregated into readily marketable, inactive, and other classes of securities. The classes of securities contained in the investments of both banks will have to be valued alike, while large blocks of securities for which there is no

ready market will be subject to special valuation according to agreement reached.

5. Loans and discounts

This is one of the most important items among the resources. Loans and discounts should be segregated into good, slow, doubtful, and bad. They will have to be carefully examined by committees consisting of members of both banks. Credit files should be examined as to the latest information. The value of collateral, indorsers, and guarantees, if any, must be considered, and the same percental reserves should be set up or adjusted for slow and doubtful, while full reserves should be set up for bad loans and discounts.

"Accrued interest and discount collected—not earned" should also be calculated.

6. Bills purchased

While loans and discounts are based upon deposit balances and collateral, bills purchased will represent discount of notes and trade acceptances of non-depositors, commercial paper purchased in the open market, and foreign time drafts. It will be necessary to investigate the credit and financial standing of the names appearing on such paper, whether eligible for rediscount at the Federal Reserve bank, and, in the case of foreign currency drafts, the discounted market value at the date of consolidation.

7. Bonds and Mortgages

All documents must be carefully examined, and where recent appraisal values are not in the files, the underlying properties should be valued by independent appraisers to insure legality and safety of loan.

8. Customers' liability account of acceptances

The same care will have to be exercised as to loans and discounts. They will be segregated into those secured at the time of acceptance only and those secured by physical collateral during the life of the acceptance. The customers who received the collateral on trust receipt will be segregated into those whose trust receipt line is a part of the open credit line and those who will be made to live up to the terms of the trust receipt.

The collateral to acceptances which will be delivered against payment only should be examined carefully and may have to be inspected at the respective warehouses or storage places. The market value of merchandise, particularly when large quantities of certain commodities have been financed, will be an important factor. Utmost care should be taken in connection with collateral to renewed or partly extended acceptances to ascertain that such collateral is still in existence.

Whether commission is charged at time of acceptance or at time of payment, the proper accrual or commission collected—not earned—will have to be considered.

9. Real Estate

Under this caption we have real estate owned by the bank. This may be its own premises, property formerly occupied, or real estate taken over in payment or settlement of former obligations to the bank. The values should be ascertained by independent appraisals.

10. Accrued Earnings

Accrued income from investment; interest on deposit balances with other banks; interest on loans, bonds, and mortgages; advances against foreign drafts; acceptance commissions and other commissions and fees for services rendered and usually charged

at maturity or after completion of contract; and similar items will be included in accrued earnings and added to "undivided profits."

11. Hidden Assets

Most of the hidden assets will be disclosed by ascertaining true, market, or fair values of the resources. These may be investment securities written down to below cost or market, real estate obtained in settlement of loans, real estate owned and depreciated while the true value may have become enhanced, profits in foreign exchange transactions, which will be ascertained by calculating exchange positions on a liquidating basis, profits in joint and trio accounts, where another institution acts as managing partner and distributes the profits, profit shares in pools formed to support the market or certain securities, recoveries declared and expected on accounts previously written off, and many similar items too numerous to state in detail.

VALUATION OF LIABILITIES

While one would expect that liabilities could be taken at book figures, it is important to classify liabilities as well as resources, and to segregate those in both institutions from those in one bank only.

1. Demand deposits

Certificates of deposit, certified checks, and officers' and dividend checks can be taken at book value. Very rarely a bank will draw its expense and other checks on another bank and reduce "due from banks" instead of setting up a "demand deposit." Individual deposits—checking accounts—should be examined, especially the large ones, to ascertain whether they are of a permanent na-

ture or will be eliminated when related loans mature.

Federal, state, county, and municipal deposits may be very profitable or the opposite, if a high rate of interest is allowed and the accounts become very active; they may also be of a temporary nature only and may be withdrawn in case of consolidation with another bank, particularly when a state bank is merged into a national bank, or vice versa.

2. Time deposits

While interest at a relatively high rate is allowed on special, savings, or time deposits, the cost of carrying these accounts is much lower than that of demand deposits and one-half of the amount on deposit, or 25% of "capital funds," can be loaned on improved city real estate, which may give time deposits a value equal to or even in excess of demand deposits.

Of course, when speaking of valuation of deposits, we mean the later consideration of good will or earning power to be capitalized, as the actual book figures will have to be taken as liabilities to be deducted from true resources to arrive at the basic amount to which good will and other factors may be added before the final valuation of the bank stock is ascertained.

3. Due to banks and bankers

"Due to banks" should be segregated, and if one bank has many correspondents' deposits reaching a large volume, due consideration should be given to the net earnings resulting from such deposits as compared to those from individual deposits.

If overdrafts in foreign currency deposits are contained in this classification, market values of such short positions will have to be ascertained

after the correctness has been proved by reconciling statements received from abroad.

4. Accounts and bills payable

These should be carefully scrutinized to establish that they are true liabilities and not partly earnings; also to ascertain that no liabilities under contracts, agreements, or guarantees have been omitted or understated.

5. Acceptances

This is the contra to "customers' liability account of acceptances" and will be taken at book figure.

6. Liability as indorser on acceptances and foreign bills

This represents acceptances and foreign bills sold or rediscounted. The items purchased appear in "bills purchased" or in "own acceptances" or "acceptances of other banks purchased," which latter items may be subdivisions of "bills purchased." This group may also be treated as an indirect liability and deducted from the respective resources. The book figure will represent its value.

7. Unearned discount

An analysis of this account will show what part should be added to "undivided profit." "Discount and interest collected—not earned" should be carefully calculated and set up, if not properly provided for. In the case where commissions or fees are charged for services not yet performed or for credits granted that have not been used, the unearned portion should be deducted from "undivided profit" and set up as a liability.

8. Accrued taxes, interest, expenses:

Proper accruals should be set up for interest payable on deposits, all classes of taxes, and expenses incurred.

9. Capital, surplus, and undivided profit

The capital funds will be subject to adjustment based upon the revaluation of resources and the establishment of net earnings, including accruals.

10. Undisclosed liabilities

They may consist of "income collected—not earned" or expenses incurred for which no liability is provided, which should be ascertained by the investigation previously discussed. There may also be liabilities pending on account of errors of omission or commission and pending litigation or lawsuits, which it is difficult to ascertain at times.

ANALYSIS OF EARNINGS AND EXPENSES

1. Ratio analysis of both banks

The resources and liabilities of both banks having been classified, the earnings and expenses of both institutions should be classified correspondingly and the ratios ascertained for comparison. The ratios which have been discussed in the preceding conference reflect the success of the management and conditions which may be applicable to one of the two institutions only.

2. Earnings and expenses from sources contained in one of the two banks only

One bank may have a well established trust department and act as registrar and transfer agent, while the other may have a foreign department and a large acceptance business. The net income received from those sources will have to be considered and the possibility of increasing the revenues through increased capital funds.

3. Non-recurring profits and losses

These should be segregated from profits and losses customary in the business conducted. Losses incurred in certain departments or in divisions which have been closed are changed into non-recurring losses. While they have affected "undivided profit or surplus," they should be eliminated from the earnings used for calculation of good will.

4. Reserves and accruals

These have been discussed under the different classes of resources and liabilities. An analysis of prior years' reserves will disclose whether excessive reserves or insufficient amounts have been set up out of any year's earnings.

5. Dividends paid

Dividends paid will have to be considered in the valuation of the stock. While continuous large distribution of dividends may help to establish a higher market value of the shares, it decreases the capital funds over a period of years and increases certain ratios of earnings compared therewith, unless the dividends paid are added to the capital funds for comparison purposes.

VALUATION OF GOOD WILL

Many different opinions exist as to valuation of good will, which represents the value of the business over and above the asset value. Where one bank is sold to another and cash is paid for its stock, the earning power of the bank, its progress, its location, and many other factors may become more important than the volume of deposits. When banks are merged on an exchange of shares basis, the valuation of good will also depends on the nature of business and many factors besides deposits.

1. Volume of deposits

Where both institutions are of similar nature and the ratio of net earnings to gross deposits is about the same, a fixed percentage, usually 5% to 10% of the average deposits for the last three, five, or more years, will be added to capital funds.

It will depend upon the make-up of the deposits, on the interest paid, on the different ratios of earnings and expenses, whether this is a fair basis.

2. Earnings in excess of fair return on capital funds

A bank with a large trust department and with deposits three times capital funds may be merged with a bank having deposits more than six times its capital funds. Obviously, the earnings will be of more importance than the respective deposits.

The net earnings of both banks can be capitalized, irrespective of capital funds, to arrive at a value for the capital stock, or a more equitable basis can be adopted. Assuming 10% to be a fair return on capital, deduct 10% of the capital funds from the net earnings and multiply the remainder, which is the excess, by five, to arrive at the good will value. This is equivalent to five years' earning power or capitalizing excess earnings at 20%.

3. Dividends paid

While dividends paid, being a distribution of profits, does not change the net earnings, it reduces the surplus and should be added to "capital funds" if the rates differ in the two banks. This will make the proportion of earnings on "capital funds" and excess earnings more equitable.

MARKET VALUE OF BANK STOCK

When banks merge on an ex-

change of share basis, the market value will be of little importance, and the market price will adjust itself to the basis of exchange. When, however, an option is given to the stockholders of one bank to accept shares or cash, the market price will become of the utmost importance, and may prevent such a merger.

Usually the market value is affected by dividends paid and earnings shown per share. The price of the stock of individual banks may vary between fifteen times and thirty times earnings per share. The control of the stock being vested in comparatively small groups, only a minor part of the stock is actively in the trade, and the price will depend upon demand and supply more than on the intrinsic value of the stock. It should be a minor consideration in arriving at a fair valuation of bank stock in consolidations.

Discussion

WM. E. PEASE (Commercial Trust Company of New Britain, New Britain, Connecticut): Under what conditions would a merged bank be favored by applying a flat percentage of deposits as good will?

MR. DJORUP: I am glad that question was asked, for just before I came downstairs, I worked out a little sample of how the valuation of stock could be affected by taking a flat percentage of deposits.

Take a bank with a trust department and deposits of \$15,000,000, and capital funds of \$5,000,000, consisting of 20,000 shares, which were originally subscribed for at par, \$2,000,000, a surplus of \$2,000,000, and undivided profits of \$1,000,000, with earnings for the year

of \$1,000,000. The book value of that stock would be \$250; the deposit value, taking 10% of deposits, \$1,500,000, which divided by 20,000 shares would be \$75—in other words, would give a valuation of \$325 per share.

Take a bank without a trust department, more in the commercial business, with deposits of \$30,000,000, capital funds under the same consideration, \$5,000,000, \$2,000,000 capital, \$2,000,000 surplus, \$1,000,000 undivided profits. The book value would be the same, \$250 a share. The \$30,000,000 deposits would give \$3,000,000 as good will value for 20,000 shares, \$150 a share. There would be a flat valuation then of \$400 a share for the bank without the trust department, as against \$325 for the bank with the trust department, while both banks have the same earnings.

If it takes 20% of the capital funds, \$500,000, we have left for both institutions \$500,000 as excess earnings. Taking the excess earnings, the 20% will give \$2,500,000 as a value of the excess earnings of both institutions, \$125 a share. Adding the \$125 a share to the book value of \$250 gives \$375 a share for the value of the stock of both banks, which would be a fairer valuation for the stockholders of the bank with the trust department, which will have the same earning power as the bank without the trust department, although their deposits are \$15,000,000 as compared with the \$30,000,000 of the other institution.

CARL C. MILLER (First National Bank & Trust Company, Port Chester, New York): I should like to ask Mr. Djorup why banks sometimes lose part of their deposits in mergers.

MR. DJORUP: There are many reasons why banks lose part of their deposits. A merchant or a manufacturer may want to have at least two banks with which he deals, not to have all his eggs in one basket. If the two banks that merge both happen to be depositaries of that merchant, he will have only one bank left as his regular bank account, and he may take part of that deposit and transfer it to another institution. Sometimes business men have had experience with one bank, and for some sentimental reason may not want to deal with a certain other bank. If those two banks are merged, the depositor may cut down the deposit and transfer it to another institution. Frequently merchants have formed a friendship with a certain officer who practically controls the deposit. When the banks merge and certain officers change to other institutions, the deposits will go with them to the institutions that they join.

There are numerous other reasons why banks lose part of their deposits.

J. LEONARD HOFFMAN (Federal Reserve Bank, Baltimore): Upon what conditions would one of two merged banks be favored, taking the five years excess earnings as a value of good will?

MR. DJORUP: When one of the banks has progressive growing earnings and each year the earnings increase in a certain ratio of percentage and another bank is an old established bank and its earnings remain stationary, the bank with the increasing earnings will lose by taking five years earnings as compared with the other institution whose earnings are not subject to an increase; also, if a bank has some extraordinary profits that may not occur again included in its

earnings. One bank may have investments and the market value of the securities may have increased, let us say, prior to the summer of 1929; it may have disposed of part of its investments and made a big profit. If that profit is included in the earnings of that institution, that institution thereby will be favored by taking flat five years' earnings and not picking out nonrecurring profits and losses and not taking into consideration the progress from year to year as compared to the stationary position of the other institution.

KEITH W. CLAGUE (San Diego Trust & Savings Bank, San Diego): What time deposits do we have in the foreign exchange departments, and why should they be taken into foreign consideration?

MR. DJORUP: In some foreign departments we have time deposits and foreign currency deposits running into large figures. Those foreign currency deposits are sometimes dangerous if no contact has been made or agreement signed by the depositor that the money is deposited for his account with the foreign institution. Not many years ago the Bank of Italy stopped payment on a bank that had had those foreign currency deposits and had been taken over by the state department in New York to have its affairs straightened out, until the bank in Italy resumed specie payment. So foreign currency deposits should be taken into consideration in valuing the stock of the one institution.

MR. MILLER: I should like to ask Mr. Djourup whether the procedure just outlined is always followed through on bank mergers?

MR. DJORUP: No, it is not, I am sorry to say. Many banks simply take the deposits and book value.

They arrive at the price first, and then regret it afterwards.

MR. MILLER: In all the cases I have seen of mergers, you could take the newspaper and find out that the exchange of the stock was on the basis of the newspaper quotations.

MR. DJORUP: I differ with you. The newspaper's quotation will be on account of the basis of the exchange of stock, for usually somebody knows far in advance what the exchange will be and the price is adjusted to the exchange of stock basis.

MR. MILLER: You mean, then, when two or three banks merge, the price is determined and then put in the newspaper accordingly?

MR. DJORUP: The price is usually determined among controlling factors long before the public knows anything about it.

MR. MILLER: I have seen cases of mergers come through where there are three banks. The stock of the bank that is going to take over the other two may be selling at \$150 a share, for example. Bank No. 2's stock is selling for \$75, and bank No. 3's stock is selling for \$100. Invariably when the literature would come from the bank that was taking over the other two, you could take that newspaper and find out that the plan that they had set forth was in accordance with those prices. The price would be exactly in proportion to what the newspaper reported the market price on the different banks to be.

MR. DJORUP: But the literature that came from the banks was prepared weeks before and the newspaper prices were in accordance with those ratios.

MR. MILLER: Then the prices are not established in accordance with the

scientific plan that you have given us.

MR. DJORUP: Market prices are never established on any scientific plan. Market prices are established on supply and demand.

MR. MILLER: Then most mergers are brought about on market price.

MR. DJORUP: No they are not. The market price adjusts itself to the merger basis. As soon as the minority stockholder finds out that he is going to get two shares for one of another institution, he will value his stock according to the two shares that he is going to receive at some future date, and he won't sell a share of the stock of his own institution unless he gets the value of the two shares that he could get in exchange later on.

C. B. HERBERT (First National Bank, Fort Smith, Arkansas): In case of pending consolidations, would you advise an audit of both institutions, and if so, by whom?

MR. DJORUP: If a bank contemplates merging with another institution and knows that it is going to be merged, each bank ought to do a little house cleaning. Each bank ought to make an examination of its own affairs. When a bank knows it is going to be merged, it should have its records in as good shape as possible, and it should have its assets and liabilities in good shape. Each bank should know what doubtful assets it has, and whether it wants to include them in the merger or whether it wants to set them aside to be liquidated on behalf of its own shareholders. It can find it out only by making a close examination of its own affairs. Usually banks examine themselves by forming committees.

PAUL H. HOHMAN (Bank of California, San Francisco): If all

stock is not turned in on a consolidation, can the bank be dissolved? If a bank is being absorbed, must all the stockholders turn in their stock?

MR. DJORUP: All the stock will have to be turned in before it can be dissolved. Sometimes banks will have to be maintained alive, although they are dormant, until the stock has been received. Some of the stock may be in the hands of an estate and tied up for a time and they may not act quickly; they may sometimes take a year before the stock is called in.

MR. HOHMAN: For instance, if I had some stock, could I hold out and not turn in that stock? In other words, that bank could not be dissolved until I turned in my stock. They might buy me up at a better price in order to dissolve the bank.

MR. DJORUP: You cannot get a different price. I believe that in some states the amount can be put up in court until it is called for and the bank can then be dissolved.

THE CHAIRMAN: Has any one a different opinion on this same question, or another question?

MR. DJORUP: When I was asked once to give a little talk on good will and intangibles, I tried to find some book that would give the valuation of good will and a method to pursue. After a long search, I found *Mathematics of Accounting*, by Curtiss and Cooper, and in Chapter 23 are given a number of examples of how to value good will. Some of you may some day have a problem in good will valuation and get books that are written on good will that deal with generalities that do not give you any specific facts. You will find this very interesting. It is published by Prentice Hall. I looked into twenty books before I got this.

Audit and Control of Non-Cash Collections

By E. C. LINDMAN

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Address before the Denver Departmental Conference

Mr. Lindman, in making a study of the audit and control of non-cash collection items, has made a survey of the methods used by sixty-one different banking institutions. The statistics which he has gathered reveal the fact that much less attention than is desirable is given to the audit of collection departments. As a result of his findings, he has been able to make several valuable suggestions.

He has outlined a complete method of audit and control; in connection with this, he considers in detail cash and non-cash collection items, control account, forms, and audit procedure. For those who feel that the method outlined is too voluminous for practical use, he has indicated which parts of the method may be eliminated without too much loss.

In presenting the various methods used by different institutions, Mr. Lindman has shown that his complete method will give an adequate control; the shorter methods will give only partial control.

UPON the assignment of this subject, I immediately corresponded with the auditors of the leading banks in the United States. My intention was to obtain a summary of the methods used by them in making an audit of their non-cash collections. Replies from sixty-one banking institutions revealed the following results:

Thirty-two make no audit of their collection department; twenty-three make a periodical audit; while six verify tracers only. The aforementioned statistics reveal the condition that little attention is given to the audit of this department, and all of those with whom I have been in correspondence, have expressed a desire to maintain a better and more complete control of their non-cash collections. Great interest was manifested

by certain institutions in an efficient control of the department, for recent defalcations had shown the necessity of it.

CASH AND NON-CASH COLLECTION ITEMS

In order to avoid confusion, I shall define non-cash collections as consisting of those items which are first collected and then credited, and cash items as those which are first credited and then collected. The volume of collection items passing through the various banks daily is tremendous. The amount varies considerably in the different institutions, depending on size and nature of business transacted. Among the different departments interviewed, some reported as high as five thousand collections daily, while

others reported as low as twelve. These items consisted of incoming and outgoing collections: notes, acceptances, drafts, coupons, and so forth.

My first intention is to set before you a method of control, which, although not fool proof, will have the tendency to reduce to the minimum the opportunity for defalcation and error. The plan I suggest may seem to some too cumbersome and expensive to place in actual operation, but ideas may be derived from it that may prove beneficial, or it may arouse creative thought along similar lines. I will next cite to you a few of the methods used by various banks with which I have corresponded, and perhaps some good may be derived from these different systems.

CONTROL ACCOUNT

The first essential in this connection is the setting up of a control. Setting up and maintaining a control has been declared by some institutions to be impracticable, because of the labor involved, and after experimenting for a time they have cast it aside. Without a control, however, it is practically impossible to maintain a satisfactory audit. There are some banks which do maintain a control of their collections. A control is kept on other contingent liabilities, as, for instance, on "customers' bonds for safekeeping." Then why not a control on collections?

FORMS

The Fanfold forms have been adopted by many banks for use in the collection department. As many as six or eight records are made of

the item in one operation. These copies are generally used as follows:

1. Collection letters: sent with item
2. Return receipt: signed and returned by receiving bank
3. Main office copy: sent by branches to main office
4. Tickler record: maturity file
5. Depositors' file copy: advice to depositors
6. Numerical record register: takes place of old type register
7. Auditor's copy.

The original copies made are numbered consecutively, and each duplicate bears the same number as its original. The numerical record register may be either a spring-back binder or a post binder. The copies for each day are inserted in the binder in numerical order, and a debit is made for the total amount to the control set-up. The outstanding items in this register must at all times agree with the total amount of the control. As the items are paid, they are marked off on the register and credit for the total is deducted from the control amount.

AUDIT PROCEDURE

The proper control would be to maintain a similar record in the auditor's department from the auditor's copy mentioned before. These copies can be filed in a similar binder without much extra labor. It will be necessary for the collection department to forward the "advice of payment" on each collection item direct to the auditing department, where the paid items can be marked off from the auditor's numerical register. This will keep before the auditor or his assistant a constant record of all items outstanding, as well as calling

attention to those items which are overdue or not paid within a reasonable time.

Proper credit for exchange collected, negligence in giving proper attention to protestable items and unprofitable practices of routing collections, theft of interest due on bank books left for collection—any of these may come before the auditor through this record. These are important details of a collection department, and negligence may result in heavy losses.

Items received for collection in the morning and paid during the day would not enter into the auditor's register, as they would be offset at the close of the day by the "advice of payment" slips received from the collection department. They should be forwarded to the auditing department in order to maintain the numerical sequence. Items held too long and receiving "no attention" would be ordered returned by the auditor, thereby keeping the files clear.

Registered mail should be opened in the presence of two witnesses. It should be listed as to contents in detail and a duplicate record delivered to the auditing department. Collections received from other departments should be listed on an interdepartmental delivery sheet, receipted for by the collection department, and a duplicate copy forwarded to the auditors. These records may also serve for verification purposes periodically.

At the time of the audit, the auditor's register can be run and the total amount compared with the total on the control. Outstanding domestic collections could be verified with the collections on hand. Outgoing collections outstanding would be checked off as payments came in, or verifica-

tions could be made direct with the collecting bank.

All collections should be examined for proper indorsements and documents. The documents should be scrutinized carefully, and all stocks, bonds, and other securities verified. Collections paid during the day of the audit should be checked as to remittance or proper credit, so as to prevent the use of the payment to cover up shortages.

In many cases collections are left by non-depositors. When an item of this nature is paid, it becomes necessary to hold the proceeds over until called for by the customer. In some banks cashiers' checks are made out and held until called for, while in others a "collection proceeds" account is carried in the individual ledgers. A control is maintained on the account and a complete record established.

SHORTER METHODS

If there are those who feel that the method outlined is too voluminous for practical use, then the auditor's register can be eliminated and the auditor's staff can check the collections outstanding at the time of the audit with the collection department's register. In this case a record must be kept by the auditing department of all outstanding collections at the time of the audit, and these would have to be checked off as payments are received. A visit can be made to the department each day, and the paid items can be checked off until the record has been verified in full. One auditor having two hundred collection items per day informed me that this method was used by his institution, and he found it very practical.

A complete audit every three months, with periodic checking in between, would suffice. The same system of audit as that used at the main office is also applicable at the branches.

The rotation of the clerical help in this department would aid materially in detecting the failure to register collections for the purpose of bringing about a "float" for personal means.

A periodic audit only, without a control, is not sufficient to maintain an effective audit of this department. It has no doubt a beneficial effect for a time, but this will soon wear off. There are other institutions where the "tracers" only are checked by the auditing department. This also is insufficient for an effective control. All tracers should, however, be delivered to the auditing department direct by the mail clerk. This will enable the auditor to investigate the reason for the delay in remitting. The auditor should also receive all examiner's requests and verification forms, as in this way different items will be called to his attention.

OTHER METHODS OF AUDIT

It has not been my intention to tell you how your collection department should be split up into various divisions. The size of your department and the volume of collections would determine that. There is one institution that permits no cash to be handled by its collection department. In this particular bank, the department is divided into two separate parts, the collection and the note tellers' department. The latter department acts as cashier for the collection department, as no cash is handled by that department. All items due are charged on the morning of maturity to the note

tellers' department where collection is made. The collection department is notified at the close of each day of all unpaid items and those upon which payment has been refused are returned to the collection department, proper credit given to the note tellers' department, and the items returned by them to the customer. In this way one department maintains a check on the other.

Another method of audit used by some banks is to have all collection department incoming mail delivered to the auditing department for a period of two weeks. Here a complete list is made of all remittances, tracers, and complaints, and the mail is returned to the collection department. This record is then followed through for proper credit on each remittance. The tracers and complaints are followed through to determine the cause of delay. An audit of this nature should be made, if possible, without the knowledge of the department audited.

In some institutions an auditor is placed in the collection department for a period of approximately two weeks, and it is his duty to check over all collections and remittances for each day's transactions; at the expiration of the allotted time, tracers are sent on all outstanding collections. Failure to register collections may or may not be revealed by using this method.

I have endeavored to present to you the various methods used by different institutions for the audit and control of non-cash collection items. The first one will give an adequate control; the other methods, only partial control. The various divisions of a collection department I have avoided as not pertaining to the sub-

ject, since the number requisite is dependent on the volume of work.

Discussion

MR. LINDMAN: One person who answered my questionnaire said that he doubted the advisability of discussing a subject on which there is so little developed, and thereby openly admitting to those in charge of collection departments that they cannot be effectively controlled and audited.

THE CHAIRMAN: I think that when a condition exists in banks which seems entirely unsurmountable, and especially when losses are occurring in such amounts as Mr. Lindman mentioned, it is high time that the auditors were doing something to curtail the malpractice of those who have no conscientious scruples or sense of honor. I myself know it to be a fact that the treatment of the subject of control of non-cash collections has been shoved aside from year to year, in the thought that perhaps we might have something more to offer before we put the subject on. Procrastination is the thief of time, however. If we wait longer, some bank may be lost forever. I think it is time we were hitting the thing right in the middle with what knowledge we have. We can add to it next year and next year on down the line until we get the matter under control. I think Mr. Lindman is to be congratulated on being the first to muster courage sufficient to tackle a subject so many have previously refused.

WILLIAM MILLER (Federal Reserve Bank, New Orleans): Suppose the collection department fails to put on its records any item that it may send out. How would the auditor make an examination?

MR. LINDMAN: Do I understand you to suggest the possibility that the collection department failed to make the regular collection register copy?

MR. MILLER: Provided the forms are not numbered. In other words, if you use a type form, it can be made up and sent out and kept out or the money received; it is not in the auditor's control.

MR. LINDMAN: If I understand you correctly, you are referring to the case where a clerk in a collection department does not follow the regular forms that are used in that department but sends out a separate letter entirely from the regular collection form letter.

MR. MILLER: The same form may be used but it is not in your control, if you haven't the number system. If your form is printed, or you are using the old typing system, you make up an ordinary form and send it out, get the payment for it, and keep it out, but don't put it in the control. How would you detect that?

MR. LINDMAN: You will remember that I stated that it is important to have your forms numbered consecutively and that every form should be sent to the auditing department so that that department can follow the sequence of those numbers right down the line. If there is one form that fails to reach the auditing department, it is immediately questioned. If you don't number your forms, you can't control the situation.

MR. MILLER: We do have control of our collections.

W. H. LINDSAY (Provident Trust Company, Philadelphia): The clerk at the window who takes those bonds or deposit collections can misappropriate those, have them collected, by not using the regular forms. You

haven't any way of overcoming that in the system that you outlined.

MR. LINDMAN: You mean, in case the clerk refused to make out the regular form?

MR. LINDSAY: I mean where a clerk gets bonds from a customer, collects the bonds, and fails to make out any record at all.

MR. LINDMAN: That you can't control, no matter what department you go to. The only way you could detect that would be that when the customer comes back and asks for his money, he may go to a different teller in the collection department. If he happens to hit the same one, then of course he has to dish up the money right then and there.

MR. LINDSAY: You haven't found any way of eliminating that?

MR. LINDMAN: If the clerk won't obey instructions and make out records, you can't control anything in any department.

LOUIS SCHAEFER (Boulevard Bridge Bank, Chicago): Wouldn't the rotating of your help take care of that sort of situation?

MR. LINDMAN: It would if the customer would delay long enough in returning for his funds. I believe that if a man came with some bonds and left them for collection, he wouldn't wait very long before coming and asking for his money. He is leaving those bonds there shortly before maturity, and he is going to come back inside of a week, or two weeks at the longest, and ask for his money. The only way manipulation could take place would be if somebody else came the next day and left some bonds; then he would use that float in between, which, I believe, would be a very difficult thing to do.

MR. SCHAEFER: What I mean by rotation of help is this: I believe that defalcations have occurred mostly where a person has absolute custody of his own work; that is, where he has no vacations, or has had no relief. In fact, those things have happened in savings accounts; they have happened in the collection department in one of our largest Chicago banks. This man never had a vacation and he was never relieved. It has happened in the clearing house department, where a certain man has never had a vacation. That is one of the reasons, I believe, why the Chicago Clearing House Association makes it compulsory for a man to take his vacation yearly, and to have regular relief each day. In fact, they are recommending, I believe, the rotation of help among the tellers.

MR. LINDMAN: Rotation of help has always been recommended, especially in the savings cages, where manipulation is possible; but if your savings cages are divided into strictly receiving and paying, you will find that the misappropriation of funds will be very difficult. Rotation would help immensely in the collection department, however, where the clerk fails to register the collection.

J. FRED BROWER (Wachovia Bank & Trust Company, Winston-Salem, North Carolina): We handle several hundred domestic and foreign collections daily, but we do not have a control system. We have a system consecutively numbered, and we have a teller who has charge of receiving all these collections. Then he sends them up to the collection bookkeeper. The collection bookkeeper records them, and, when they are paid or returned, another man stamps the fact on the copy and they

are received by one clerk and entered on the Fanfold form. If they are returned or paid, they are entered by another clerk. If they are not attended to very promptly, an assistant treasurer, who has full charge of that department and keeps up with all the numbers, writes personal letters. In other words, he takes the place of an auditor in the matter and keeps in touch with all the numbers, and every morning he looks over both the domestic and foreign registers to see whether all the numbers are consecutively listed and to see whether there are any outstanding that have not been reported to him for any length of time.

MR. LINDMAN: You have a very good control there.

THE CHAIRMAN: That was very well described. It is really a complete break between paying and receiving and is fundamentally sound.

WILLIAM MCARTHUR (First National Bank and Trust Company, New Haven, Connecticut): How would you proceed to audit contract collections?

MR. LINDMAN: I think you are referring to land contract collections. I believe that they cannot actually be audited. I regard land contract collections as separate from the col-

lection department entirely. I look at them more in the light of a regular deposit by a customer of the bank. If he fails to receive a payment on his land contract for a certain month, he is immediately going to inquire why. If it hasn't gone through, he gets in touch with his client and finds out why the payment hasn't been made.

That is the only way I know of that you can audit land contracts—by leaving it to the customer. If his client did make the payment, investigation at the bank is bound to follow. If there is any one here who has another system, I should be pleased to have him tell us about it.

MR. MCARTHUR: We have a contract, a general mortgage, covering a large section. The lots are sold, the contracts are turned in to the collection department, and as the collections are made, the money is turned over regularly to the discount department to apply on the reduction of a loan that is in the discount department backed by the general mortgage.

MR. LINDMAN: But you have some contracts where you credit the payments directly to the customer's account, don't you? You have no method of controlling those.

The Auditor As Watch Dog for and As Adviser to the Chief Executive

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The chief executive's watch dog—that is the real status of an auditor, Mr. Schaefer believes. Vigilant in his scrutiny of the bank's system of handling detail, eager to promote the good will of customers, keen in his scent for any laxity or crookedness in employees or officers, and energetic in his pursuit of profit for his bank, this member of the institution has frequent occasion to prove his faithfulness and devotion to the bank which he serves, and upon his conscientious performance of these arduous duties depends much of the success of his institution.

THE auditor of the bank in the strict sense of the word is directly accountable to the board of directors. As the individual held responsible by that body for the accuracy of the figures appearing on the bank statement, he finds himself in possession of certain facts and information which, if properly presented, will enable him to act in the capacity of Watch Dog for and Adviser to the Chief Executive.

The extent to which the auditor may approach the chief executive in an advisory capacity will depend largely upon the type of man at the head of the institution. If the chief executive has, himself, come up through the ranks, he will readily observe pertinent facts even before the auditor has a chance to present them. But, where the position of chief executive is occupied by a man who is not, strictly speaking, a banker, the auditor enjoys a greater opportunity to act not only as an ad-

viser but also as a guide in banking practice and procedure. In such cases, and they are becoming common in these days of mergers and closer association between industry and banking, the alert auditor must be able to give his superior a complete picture of the operation of the bank in language that the chief executive understands. Some executives keep open house at all times for suggestions and are receptive to recommendations not only from the auditor but from the other members of the staff as well. On the other hand, there are those who do not take kindly to general suggestions and advice and, with a man of this type, the auditor must naturally adhere to the generally prescribed duties of his position.

THE AUDITOR IN THE LARGE AND IN THE SMALL BANK

The opportunity for the auditor to act in an advisory capacity depends

not only upon the type of individual at the head of the bank but also upon the size of the institution. Large banks are usually highly departmentalized. In such cases, the auditor has clearly defined responsibilities and must of necessity delegate to his staff the work of gathering and compiling such data as he requires; nevertheless, he must keep himself informed as though he were doing the actual work. In a small bank the tasks of the auditor are not always confined to his particular line. For example, it is not unusual for him to be placed in charge of personnel, operations, and even purchasing, and often he discharges all the duties of this combination with little or no help. Here the scope of his activities places him in an excellent position to observe conditions at first hand.

There is no set rule or formula which the auditor can follow in acting as watch dog for and adviser to the chief executive. He must be a keen observer, able to see beyond the figures for which he is held accountable. He must train himself to be constantly on the alert for those things which the chief executive ought to know. If the auditor is to be the watch dog for and adviser to the chief executive, he should focus his attention on opportunities for developing internal systems in keeping with progressive banking practice and procedure, on maintaining organization morale and efficiency on the highest plane, on safeguarding customer good will, and, above all, on seeking opportunities for increasing the bank's profits.

Methods and systems in the handling of detail are tested and proved by the operation of the organization.

Inadequate or defective systems should be brought to light through periodical audits. When the auditor is satisfied with existing methods because they are workable, he shows a tendency to stagnation, and, in these days of rapid advancement in machinery and ideas, no auditor can afford to let himself fall into this mental state. Inadequate or defective systems provide fertile ground for defalcations, and, although it is chiefly the auditor's duty to uncover irregularities, his greater responsibility should be to establish safeguards against them. Looseness in operation needlessly increases handling costs and thus causes a constant shrinkage of profits. Flow of items should be continually watched to avoid unnecessary handling. When frequency of handling can be curtailed, the possibility of error is reduced in proportion. Some duplication of effort in bank work is unavoidable, but by the vigilance of the auditor it can be reduced to a minimum. Constant effort, therefore, to increase the efficiency of the bank's internal systems and methods in order to keep operating costs down is a vital part of the auditor's responsibility as watch dog for and adviser to the chief executive.

PROMOTING GOOD WILL

The preservation of customer good will is of as much importance to the growth of a bank as is the securing of new business. The smallest detail or the slightest contact will often tend to promote or to destroy friendly feeling. For example, all commercial customers, even those who do not often visit the bank, are reached through monthly statements. When

these are rendered in an incorrect or slovenly fashion, they are bound to bring dissatisfaction. Discrepancies, of course, are inevitable and may even be insignificant when compared to the volume of work handled. However, when their recurrence is sufficient to annoy or inconvenience the customer and endanger good will, they are costly, and here again the watch dog propensities of the auditor are called into play. The degree of efficiency with which the bank operates is manifested to the auditor by the number of complaints which come to him and his department. With this situation automatically placed before him, he is supplied not only with the means of preserving efficiency, but, when the occasion presents itself, of offering to the chief executive valuable advice and counsel for the maintenance of customer good will.

THE AUDITOR'S CONCERN WITH PERSONNEL

Personnel, as such, is something with which the auditor does not usually concern himself. He is prone to think of the staff in terms of figures or machines. Nevertheless, the fact remains that the personality and character of the employee enter into the work he does. Though the auditor's contact with the employee is more or less remote, he should be able to detect weakness or lack of character. Laxity of control methods will furnish the loophole for the worker who has not the will power to resist temptation, or whose present status may be of a precarious nature. Such conditions may result in small irregularities. These may not appear worthy of a thorough investigation

when disclosed, but the auditor should recognize the fact that the adoption of timely measures will tend to prevent more serious discrepancies. Therefore, an ever watchful attitude toward control methods is imperative. The auditor is often handicapped because the officer in charge of personnel, in his desire to lower operating costs, overlooks the fact that it is impossible for the auditor or his staff to inspect the entire bank daily, and underestimates the necessity of supplying some departments with sufficient help for checking purposes. This is a problem which commonly confronts the auditor, and he must solve it to the best of his ability in each specific case. Because his duties put him in a position to scrutinize the work of the various departments, the auditor's advice is often sought relative to personnel. He enjoys the advantage of an impersonal viewpoint and can, therefore, easily suggest changes that some one closer to the employees may not be in a position to suggest, and in this way can aid the chief executive in maintaining organization morale and efficiency.

THE AUDITOR AS A PROMOTER OF PROFIT

A banking institution is not different from any other business. Its success depends on its money-making ability. This fact gives the auditor an exceptional opportunity to make himself valuable to the chief executive by keeping him apprised at all times of the true condition of the bank as to earnings. The auditor's purpose should be to present his statements in such a fashion that the determining factors are readily recognized and interpreted. Comparative

statements are an invaluable aid in judging the bank's progress, and, wherever practicable, it is well to use graphs or charts to dramatize the actual figures and to bring to light facts that might otherwise be overlooked or underestimated. Therefore, the chief executive must place reliance on the auditor to keep him constantly informed of the facts on which the profitable operation of the bank depends, because the standard by which the chief executive is judged by the board of directors and the stockholders is *profit*.

THE AUDITOR AND HIS SUPERIORS

We now come to a vitally important branch of the auditor's work—the one which, above all others, tests his mental qualities and his professional ability. It is here that the auditor shows the stuff he's made of. Tact, discernment, courage, and decisiveness all come into action in the auditor's relationship with his superiors—the officers of the bank. Let us forget for a moment the dignity and authority of the officer's position and consider him only as a man. Seen in this light, he is no more free from the frailties and temptations of human nature than is the teller in the cage. And, with so much more at stake, when an officer stoops to dishonesty his fraudulent acts are likely to involve greater sums of money. Often, as a direct result of large defalcations and embezzlements, the very existence of the bank is threatened, and instances have been known where banks have actually been forced to close their doors. The auditor is more likely to detect official irregularities by intuition than to

uncover them by direct checking, because an officer bent on committing fraud and knowing the inner workings of the bank may be able to conceal his acts so that they are not easily discovered through regular examinations. However, when his suspicions are aroused, the auditor must bring into play his keenest powers of deductive reasoning, endeavoring first of all to exhaust every probability of the officer's innocence. But, if doubt still exists, he must set aside his distaste for questioning the acts of a superior officer, and, as watch dog for and adviser to the chief executive, lay the complete report before him. And, should the chief executive himself be involved, the auditor must disregard everything personal for the good of the institution and make his report to the board of directors.

Sometimes an officer, in his anxiety to retain the favor of old customers or to cultivate the good will of new ones, will offer certain accommodations which are inconsistent with sound banking practice. Or, again, it may be that, having grown away from the details of the bank's routine, he will commit the bank to special arrangements which are needlessly costly or burdensome. In the natural course of events, such non-conformities will be brought to the notice of the auditor by the individual or department affected. Then the delicate problem which confronts the auditor is not so much the rectifying of the trouble as the manner in which it is done. He must bear in mind that his responsibility is not to the official staff but beyond them, and, however anxious he may be to sustain a friendly relationship between them and himself, he is required at least to confer with the

chief executive in regard to matters such as these.

THE REALLY VALUABLE WATCH DOG

By availing himself of the opportunities which come to him in the character of watch dog for and adviser to the chief executive, the auditor's capacity for promoting the progress of the bank is far reaching. His intensive study of all branches of the bank's activities obviously broadens his knowledge and improves his ability, thereby enhancing his usefulness and value to the institution and paving the way to his advancement and success. The auditor's real success as watch dog and adviser is achieved when the chief executive, with a full knowledge of the bank's true condition, is at the same time relieved of the worry and annoyance incidental to watching detail, and is thus left free to devote all his energy to the direction of the bank's progress.

While much of the foregoing might be developed and discussed at greater length, the auditor's course of action in this phase is so largely dependent on circumstances that no definite program can be adhered to. And, finally, the thought which is forced on us is that the keynote of the auditor's effectiveness as watch dog for and adviser to the chief executive is dependent upon the conditions peculiar to his organization and upon his own resourcefulness and initiative.

Discussion

JOHN H. YONTS (Home Trust Company, Kansas City, Missouri):

How far should the auditor or controller go in reporting minor differences and exceptions to the chief executive?

MR. SCHAEFER: It is hard for me to answer that question, except generally. I know that if I were the auditor, I should not want to bother my chief executive with minor things that only occasionally come up. However, I think it is the auditor's duty to discuss with the chief executive a recurrence of any detail, regardless of how minor, because it may be a condition and not just something that has happened once or twice.

MR. YONTS: We found that one man in our bank as a teller was very chummy with a certain customer, and upon checking this man and watching his operations closely, we found that he was, for a certain consideration, allowing the cashing of bogus checks for the float, which would be returned only to be taken up by another on a far distant point.

MR. SCHAEFER: I think that comes under the heading of the auditor's intuition. He only sees certain departments at certain times, and he will not be in a position to observe these things, but if he sees a recurrence, or if, while going through a department, he notices something that shouldn't be there, it is likely to be more by virtue of his own intuition than through direct checking.

ALFRED J. BLASCO (Commerce Trust Company, Kansas City, Missouri): What method do you use in informing your chief executive: a report form or just an oral report?

MR. SCHAEFER: That depends on the type of man the chief executive is. If I were to do it, I think I would rather discuss the matter with the chief executive and give him a

chance to ask questions, which I might be able to answer.

CHRISTIAN DJORUP (Christian Djourup & Company, New York): When important matters are involved, I suggest that the auditor put the suggestions in writing, as evidence that he took the matter up with the chief executive. I have known cases where the auditor took a situation up with the executive, but afterwards the executive denied any knowledge of the facts.

WILFORD GRADEL (Northwestern Trust Company, St. Louis): Should the auditor report to the chief executive, or to the board of directors?

MR. SCHAEFER: That is the eternal question. I think that the auditor is working for the board of directors; if he is not, then he is not functioning as an auditor should. His report, as I have tried to bring out, is almost incidental to his work as the auditor for the board of directors. I think that his primary purpose in any bank, is as an agent of the board of directors; but, because of his peculiar position, he can't help finding certain things that will be of advantage to the chief executive in addition to his regular duties.

WILLIAM THOELE (First National Bank, St. Paul): Is it good policy for the employees to have checking accounts in the bank where they are employed? I know that in my bank they don't allow it.

MR. SCHAEFER: I personally think that is poor practice. We don't permit it on our bank. In fact, very few banks in the city from which I come do allow it, because it is perfectly obvious that a man can easily default in a bank wherein he has his own checking account.

THE CHAIRMAN: Has any one else a thought on that question? It is a subject that has been discussed more times than one, and from many viewpoints.

HARWELL F. SMITH (Alabama National Bank, Montgomery): We have been considering that matter for some time and have concluded that although it may be easier for a man to get a little money when he has an account in his own bank, at the same time we are better able to keep up with what that man is doing if we have his account before us. It has served its purpose in two cases in our bank. We saw what the accounts were and stopped manipulation, whereas if the accounts had been in other banks, we should not have known anything about it.

MR. SCHAEFER: We considered that particular situation and concluded that if a man really wants to embezzle funds—at least, the average man—he certainly isn't going to deposit them in his bank. In most instances, the deposit is made at a bank somewhat remote from his own.

J. FRED BROWER (Wachovia Bank & Trust Company, Winston-Salem, North Carolina): I have never favored the idea of a bank's requiring its employees to deposit in other banks. Our experience has shown that it is not advantageous at all to the bank. Moreover, I think the deposit privilege is a courtesy allowed the employees. I believe it is just as well to let them deposit in the bank.

MR. SCHAEFER: I think, as Mr. Pollock says, that it is a question which could be discussed far into the night.

MR. BLASCO: Do you maintain all the employees' accounts in one

ledger, or are they distributed alphabetically?

MR. BROWER: They are distributed alphabetically.

WILLARD H. DRESSLER (Stock Yards National Bank, Omaha): We do not allow our employees to carry an account in the bank. Personally I am not in favor of it. We do learn a great deal about the habits of some of our employees, and we get a check upon what they are doing with their salary by the number of deposits they make and the time they make them. I think that feature of it is a good thing. At the same time I am not in sympathy with the idea.

MR. BLASCO: Mr. Chairman, I should like to ask just how many auditors in our group here have direct contact with the board of directors.

THE CHAIRMAN: Through a representative?

MR. BLASCO: How many send their reports either directly to the chairman of the board, or to some one designated by the board of directors?

THE CHAIRMAN: That is a good question. Let's see the hands of those who consider that they are making their reports to the board of directors.

. . . Eight hands out of eighty-seven present were raised. . . .

MR. DRESSLER: In my bank, our auditor reports to me. I am a member of the board, but he doesn't report to the board of directors. At one time we had a bookkeeper who posted a check, and when it came in he threw it back. The auditor brought it to me. Would you report a matter of that kind to the board of directors?

MR. BLASCO: In our case, a matter like that would be adjusted with the department head concerned. We can't report to the directors a small affair like that.

THE CHAIRMAN: Mr. Schaefer. I think, made a very good statement a minute ago when he said that details would not be reported unless they represented a recurrence, which might then present a *condition* rather than an *incident*.

Money Making and Saving Tips for Banks

By W. A. NIEWEG

AUDITOR OF THE FIDELITY-PHILADELPHIA TRUST COMPANY, PHILADELPHIA, PENNSYLVANIA

Address before the Denver Departmental Conference

Mr. Nieweg offers five useful tips for money making and saving for banks. The analysis of deposit accounts is of particular importance, because the earning power of deposits is often not sufficient to carry the interest allowed, together with the overhead expenses.

Another important need is the watching of the trust department profits. The unit cost system has been applied here very advantageously. Some banks lose money by making their charges for the safekeeping of securities inadequate. The work attached to the safekeeping of securities entitles the bank to more compensation than the average one receives.

One of the best methods of money saving is budgeting expenses. Giving each major department of the institution a certain sum to which it must limit its expenses, will, without doubt, hold down the expense account. The analysis of the cash held by tellers is also a money saving device, because it often provides material for considerable reduction in the amount of cash required.

THE words making and saving, in so far as money is concerned, are somewhat interdependent. It is true that it is possible to make money without saving it, but you cannot very well save money without making it.

The tips that I have to offer are five in number.

1. Analysis of deposit accounts
2. Watching of the trust department profits
3. Adequate charge for handling of safekeeping
4. Budgeting of expenses
5. Analysis of cash held by tellers.

The matter of watching the profit and loss is of great importance in respect to the deposit accounts at the

present day, as interest paid to depositors is so apt to increase, by reason of competition. Banks which offer the inducement of a high interest rate in order to increase their deposits overlook the fact that the earning power of these deposits is often not sufficient to carry the interest allowed, together with the overhead expenses.

It is a well known fact that in a number of banks today the major portion of the profits are attributable to earnings from invested capital rather than from the operations of their deposited money; and with the smaller margin of profit existing in banking, due to increased expenses and higher interest payments, an analysis of the deposits, their costs, and their profits, is necessary, in or-

der to arrive at the truth of the situation.

In a recent issue of the Journal of the American Bankers Association, an analysis made by the Comptroller of Currency of 2,120 banks in the Middle West in 1927 as compared with approximately the same number in 1908, showed that deposits had increased 179%, gross earnings 215%, expenses 360%, losses 152%, and net profit only 33%.

We can see, therefore, that deposits and gross earnings increased rapidly, that expenses increased nearly twice as fast, while net profits lagged far behind; and in an analysis submitted by Mr. John J. Driscoll, certified public accountant at the American Bankers Association last year, it was shown that the 33% increase in net profits represented \$6,500,000, while the capital and surplus had increased \$133,000,000 during the same period.

This additional invested capital of \$133,000,000, producing an income of approximately 5%, or \$6,500,000, shows that the net increase in profit was due principally to the increase in invested capital; and, while deposits increased 179% and the gross earnings increased 215%, the net profit earned from the increased deposits was not any greater than that earned in 1907 on deposits only 4/11 of the present total.

I think it would be enlightening to understand what enters into the analysis of the depositors' account, to determine what is the profit or loss to the bank.

FACTORS IN THE ANALYSIS OF THE DEPOSIT ACCOUNT

We commence with the daily

balances or book balances, which are the gross balances before deductions have been made for either float or reserve.

The deductions are those items deposited (or the float) which require a certain length of time to collect; these, although entered to the depositor's account as a credit on the day of deposit, are taken off in the analysis before allowing interest. They constitute one-day items, which are checks on the clearing house members; two-day items, which are checks on outside institutions not members of the clearing house; and extra-time items, which require three or more days to collect, and are all on points distant.

When this float is deducted, it leaves a balance, which is called "free balance." The Federal Reserve requirement of 10%, based on the gross balances is then deducted from the free balance, to ascertain the loanable balance.

Having determined the average net return on our loans and investments, we calculate the amount that the balance has earned on its free balance. From its earning by the bank, we deduct the interest allowed the account, which leaves a net earning to the bank, before overhead. The overhead is then figured on a per-item cost. This per-item cost may be anywhere from $1\frac{1}{2}c$ an item to $7c$ an item, but among the trust companies it generally averages $4c$ to $7c$ per item.

The number of checks paid and deposits made by the customer are counted for the period, and, at the cost per item, it is then determined what the activity total cost has been. This is then deducted from the net profits as mentioned above, and the

result shows us whether or not the bank has made any clear profit on the account.

It is surprising sometimes to see that what apparently is a perfectly normal balance under ordinary conditions, appears to be a loss after analysis. This situation is due principally to one or both of two things: that the depositor draws against his uncollected funds; or that he draws during the period a large number of checks.

For instance, on a scale of averages, taking a \$10,000 free balance on which 2% interest is allowed, if that account had 531 checks in the month on which the activity cost is four cents per item, the profit that the company would receive would be entirely taken up by this activity or overhead cost. We would all tend to look at a \$10,000 balance as being a fairly good account, but the outside picture of that account does not tell you the real condition which exists, without an analysis.

PURPOSE OF ANALYZING THE DEPOSIT ACCOUNT

Of course the real purpose of analyzing the deposit account, when the account shows a loss to the company in its operation, is to bring it to the attention of the depositor, but a certain consideration must be given to his connection with the company in other relations. In the case of trust companies there are many avenues through which the company may be serving this customer, with the possible development of trust business, or other business, as an outcome of the deposit account.

We have in our own company started the analyzing of accounts, and

have had some satisfactory results in the elimination of loss and the improvement of balances. Often we have had an interview with the customer and have shown him the analysis and given him to understand that we are desirous of helping him. In some cases where we have not been able to do this, we have closed the account, to put an end to the risk of returned checks and to the continual practice of drawing against the funds before they have been collected.

Some institutions have created a service charge on such accounts as show little or no profit, but there seems to be a difference of opinion as to whether this results in increasing the earnings.

If an account is approached in the proper manner, and the depositor is able to build up his balance, there is more to be gained by an interview than by instituting a service charge.

WATCHING THE TRUST DEPARTMENT PROFITS

Because of the tremendous growth of trust funds in this country, it is very important that the operating costs should be closely watched and some form of measurement used to determine the cost of handling the various estates during their lifetime.

There has been a great deal of thought given to a method for determining what it actually costs to handle an estate and how the bank can arrive at its fee. A meeting was held in Chicago about three years ago to try to arrive at some uniform system of cost that could be applied; and some of the cities adopted the unit cost system very advantageously.

For in instance, if a client approaches an institution with the idea

of leaving his estate under its management, it is well to know the cost of handling the various classes of securities; and each class, such as coupon bonds, registered bonds and stocks, mortgages, real estate, and miscellaneous items, has its respective cost, determined by the amount of work involved each year in handling each particular class.

We find that mortgages are more costly to handle than coupon bonds; and that real estate costs five times as much to handle as coupon bonds. Accordingly, to determine on what basis the fee should be charged, it is essential that we know first in a general way what class of securities the client possesses and also what is the cost of handling each particular class.

Today, when there are so many branches of the trust department which need the services of experts, the cost of running this particular department cuts into the profits considerably. Aside from this fact it is essential to determine whether the trust department is operating profitably or not, and to analyze the overhead.

There has been considerable time and thought given to this particular subject at the various trust conventions, because it was realized that trust department operations are very costly and that much service is rendered without any means of further charge. It is, therefore, most important that we ascertain the relation of the overhead to the profits, and the man best qualified to find this out is the auditor or comptroller.

The safekeeping department of a bank should be self-supporting.

Clients are becoming more and more educated to the fact that bank

service should be compensated for, like the service of a doctor or a dentist.

The work attached to the safekeeping of securities, such as setting up records, cutting coupons, collecting dividends, crediting customers' accounts, and assuming liability for misplacement of securities surely entitles the bank to more compensation than the average one receives.

The comptroller or auditor should make a periodical analysis of the accounts to determine whether the bank is receiving proper remuneration from each.

BUDGETING EXPENSES

Budgeting expenses is one of the best methods of money saving, especially in the larger institutions, where the expense account constitutes a very large item in the overhead. The effectiveness of the budget in curbing expenditure has been proved. Giving each major department of the institution a certain sum to which to limit its expenses, will, without doubt, hold down the expense account, because there is a personal pride taken by each department in keeping within the limit of the budget if possible: and it hurts the pride of the head of the department to have to ask for a sum in excess of the budgeted amount.

ANALYSIS OF THE CASH HELD BY TELLERS

Analysis of the cash held by tellers often provides material for considerable reduction in the amount of cash required. In our bank we have instituted the unit teller system. Each teller is enabled to replenish his supply of cash as needed by drawing on

the reserve teller. In this way each teller keeps his supply down to an average of from \$8,000 to \$10,000, and the reserve teller is in a position to keep the total reserve down to its lowest requirements.

Discussion

FRANK CARD (Grand Rapids National Bank, Grand Rapids, Michigan): We have recently instituted the bank teller system. We figure that we have saved between \$7,500 and \$10,000 a year just by cutting down the cash. There is a question of how often you analyze, or would you suggest that we analyze the teller's cash?

MR. NIEWEG: In our bank, we audit the cash twice a month; that is the best unit I know of for the analysis. We see at a glance then how much each teller is carrying and whether he is exceeding his limit or not.

MR. CARD: I find our greatest trouble is with our branches. The managers like to have considerable cash. Our big trouble is holding them down to the amount that they need. We figure that a branch should do business on two per cent of their commercial accounts held in cash.

ALFRED J. BLASCO (Commerce Trust Company, Kansas City): Do you analyze each individual teller as to his cash requirements?

MR. NIEWEG: Of course in our main office the tellers are on practically even keel and they are all allotted about that average—from eight to ten thousand. Sometimes it may go a little above, and sometimes it may be a little less, but on the average that is what they are allowed. Of course if we have an outlying office we can-

not hold them down to that amount. There are certain days in the week when they require probably fifty or seventy-five.

MR. BLASCO: We have been able to reduce our cash also, just by determining the requirements of each individual teller. We do that simply by taking the amount of checks paid, and incidentally the cash received during the day and considering the cash held over. You can see at once if he is holding any excess cash. Through our proximity to the Federal Reserve bank, we are able to get money immediately if we need it, so we have been making money by reducing our cash to a minimum basis.

WILLIAM THOELE (First National Bank, St. Paul): In the First National Bank in St. Paul I think the average that the tellers have will probably run about \$20,000. As a rule, the general teller runs about \$300,000 in his cage. It will probably average \$700,000 a day for the year. Of course we have a railroad center there and a heavy payroll. Toward the last of the month he does not carry so much.

MR. NIEWEG: You have combination receiving tellers and paying tellers.

MR. THOELE: Receiving and paying.

MR. NIEWEG: Each teller does the same, receive and pay?

MR. THOELE: Yes.

MR. NIEWEG: You can regulate it better where the teller both receives and pays than where they are separate.

ROBERT C. COOPER (Northwestern National Bank, Minneapolis): Do you find that the per-item costs in the different banks vary much per item, that is, in the same city?

MR. NIEWEG: I think they vary with the size of the bank and the method of handling items. The larger the number of items, the smaller would be the cost, because of the relatively small overhead. Take, for instance, the very large bank, which clears enormous numbers of checks. They may clear ten times as many checks as another bank and yet their overhead per item would be only about five times as great, so you can readily see that their cost per item would be smaller than in the smaller bank. Some of you gentlemen may have some other ideas on that.

MR. BLASCO: I believe the method of handling the items in your bank affects your cost materially. In other words, if you handle an item differently, the cost may vary for that reason.

MR. COOPER: It seems to me that the difference in cost would affect the class of the account. In one bank it would be a profitable account whereas in another it would not. I was wondering if you wouldn't have many customers changing banks.

MR. NIEWEG: Among the larger banks in our city the rate runs about the same. That is anywhere from three to five cents. Of course when it comes to the billion dollar banks, like those in New York and Chicago, the rate would be a little lower. As to the smaller outlying banks in our town, their rate would be a little higher, but the type of depositor there probably would not want to come to the downtown banks for that difference.

MR. BLASCO: Speaking of the analysis of accounts, I wonder if there isn't some way that we can analyze the accounts under \$500, which comprise, I believe, the major portion of a bank's accounts, from the standpoint

of number by using an approximation method, and then on the remainder use the analysis that Mr. Nieweg spoke about. We have recently made a test in our bank by using what we term "the approximation method," which is merely reducing costs to equivalent balances in their application to the small account. We have found that one man is able to analyze three thousand accounts in one month by using this method.

GLENN E. BRUMBAUGH (St. Joseph Stock Yards Bank, St. Joseph, Missouri): I should like to have that explained further.

MR. BLASCO: For instance, let us consider the factors entering into the cost of deposit accounts. Interest is eliminated from consideration since no interest is paid the small account. The major activity of the small account is the checks drawn. If a check on your bank costs $2\frac{1}{2}$ cents, it represents the equivalent of 6% on \$5 of deposit. The bank is entitled to a profit; therefore let us raise this balance required to \$6.66.

The items deposited in a small account usually are transit and clearing items. The average cost of these items is, say, $1\frac{1}{2}$ cents and the balance required to offset this cost is \$2.50. Let us use \$3.33 to include a reasonable profit. Deposits can be ignored unless there are more than three or four; in that case, the cost is reduced to an equivalent balance in like manner. The lending cost is negligible on accounts averaging less than \$500 and therefore not considered. The maintenance cost of the account, if it is, say, 50 cents, is also reduced to a balance equivalent, which is \$100 of deposit.

Now, let us apply all of these factors.

Balance required for maintenance cost	\$.....
Balance required for checks drawn (@ 6.66)	\$.....
Balance required for checks deposited (@ 3.33) ..	\$.....
Total balance requirement	\$.....

Deduct the required balance from the net balance maintained, and the result reveals whether a charge should be made. If there is sufficient balance to cover, the account is profitable. If there is a deficit balance, charge the customer 6%, just as if he had actually borrowed that amount from your discount department. In reality, he is using that much of your money to maintain his account. This application to the small account will produce accurate results, provided no unusual features enter into the account.

If we can have an approximation method such as I have explained, we have eliminated this great mass of small accounts; then we can use the elaborate analysis that Mr. Nieweg has explained to you.

HARWELL F. SMITH (Alabama National Bank, Montgomery): On using this item cost when you analyze your account, it seems to me that although that applies to the total of accounts, it would not work out exactly properly. In other words, if you have an account that deposits a thousand items a month and that proves to be unprofitable, if you charge, say, three cents per item, if you get rid of that account, you actually do not save that three cents per item; you save practically nothing. It looks, then, as if your loss that the account did show was on paper and could not actually be applied to that one account. If you lose the account,

you will be worse off because you will have lost what profit there was in the account before overhead was applied and will not have decreased your overhead to any extent.

MR. NIEWEG: We do not go after accounts that are not paying. Those that we let go would be those that would take advantage of us. If we had an account that was not paying and showed a fairly good balance, our method would be to try to get them to increase the balance or forego the crediting of interest, or something like that that would tend to increase the profits. We have a number of accounts where we have made arrangements with them not to credit their account with any interest. Others have come across with bigger balances.

MR. SMITH: You do run the risk of losing an account and thereby losing a little money, do you not?

MR. NIEWEG: We do, but we acquaint them with our side of the question and if the customer is fair, he will do his part. Of course if they treat us right, we carry their account for them; we would not just close it out and tell them to go some place else. We would try to tide them on and hope in the future to get them to build their account up.

WILLIAM MCARTHUR (First National Bank and Trust Company, New Haven, Connecticut): I should like to ask on what basis you arrange a schedule of charges for safekeeping.

MR. NIEWEG: We have our general file or general index in which we have a record of all the phases of work that we do for the customer such as a trust account, a money account, or a safe deposit box. Or we might be holding a will from which

we would expect to reap a harvest in years to come. If there is any case like that, that would warrant free care of the securities, of course we would not charge them anything; but if they did not have any connections with the bank that would warrant any consideration, we would go after them for their share of the expense. In our bank we have figured out that a fair charge would be about one dollar a thousand for bonds a year, and twenty-five cents for each stock certificate we hold.

J. FRED BROWER (Wachovia Bank & Trust Company, Winston-Salem, North Carolina): Don't you think the best way to handle the safekeeping where they do not get a safe deposit box and where there is a trust department is for those accounts to be kept in escrow in the trust department and the charges made there instead of having what you would call an escrow account, clip coupons from bonds and collect dividends from stocks?

MR. NIEWEG: There are a number which we call safekeeping that you might treat as escrow accounts; but when I was speaking of safekeeping in my paper, I meant customers who come in and leave \$5,000 worth of bonds and say, "We will come back for them in a week," and leave them there for a couple of years, allowing us to cut their coupons and expecting us not to charge them anything for the service. That is the class of safekeeping that I had in mind in my paper.

MR. BROWER: Shouldn't they be kept in the trust department if there is a trust department in the institution?

MR. NIEWEG: It might be best. But that is not the way we carry ours.

ARTHUR TIEDEMANN (Drexel

State Bank, Chicago): Was there any mention made of the minimum interest paid on savings accounts?

MR. NIEWEG: I didn't say anything about savings accounts, but we allow on our savings accounts.

MR. TIEDEMANN: Do you pay all interest, any amount, pennies?

MR. NIEWEG: Yes.

MR. TIEDEMANN: Our institution for some time has adopted a minimum of interest paid on balances. We started out first with a twenty-five cent minimum. We have approximately 23,000 savings accounts and 5,000 drew less than twenty-five cents interest. We put through a requirement in our by-laws eliminating payment of interest less than twenty-five cents. That went over very well with no criticism from customers at all and about a year ago we raised that to fifty cents. I should say that of our 23,000 accounts, we probably saved close to \$4,000 a year on interest, to say nothing of the saving in handling. There is no criticism at all. We don't penalize children's accounts or accounts of organizations. We find that better than a service charge. We also have a service charge, but this minimum interest penalizes the small account.

MR. SMITH: On an analysis of accounts, how many items would you count?

MR. NIEWEG: We would count the check as an item and deposit ticket as an item and also as many checks as there were on deposit. There might be twenty-five checks. It takes more time, in fact, to handle a check received on deposit than it does to handle a check charge.

CHRISTIAN DJORUP (Christian Djorup & Company, New York): I should like to make a little sugges-

tion for money making in the bank in those cities that have a clearing house and where most of the banks are in the clearing house. I feel that the clearing house ought to regulate the maximum interest allowed on accounts and a minimum commission and a minimum service charge. In those cities where they have no clearing house and there are a number of banks, if instead of competing with each other and trying to take the business away from the other banks, they got together and regulated their interest allowance and their commission and fee charges, it would give the banks a larger income instead of increasing the work and getting less income. In New York, a number of banks were giving income tax returns to their depositors free. They even went to the extent of hiring accountants to prepare the income tax returns during certain periods. While they used to do that free of charge, they are now charging from \$5 to \$100 for the preparation of income tax returns, where before that they used to pay from \$50 to \$100 a day for the accountant and give the service gratis.

MR. BLASCO: We found in our bank that it would pay us to review our forms periodically and throw out any obsolete forms because these obsolete forms clutter up the file. I think if you can standardize them in some way to prevent duplication among departments, there is a good saving to be effected.

MR. CARD: A year and a half ago we started charging our customers for imprinting their names on checks.

MR. NIEWEG: I think you could determine that according to the balance that your customer keeps with you, according to the value to the bank

of that particular balance. If it would warrant giving check books free of charge, I think a bank would be better off to do it. If a person with a \$200 balance wanted an expensive check book he would have to pay for it.

MR. CARD: We charged everybody with the exception of about half a dozen customers, regardless of the size of the account.

MR. NIEWEG: And they made no complaint?

MR. CARD: No.

WILLARD H. DRESSLER (Stock Yards National Bank, Omaha): I don't understand why you want to do business for nothing. Many of you seem to want to give that service and get no pay for it. Why don't you get together in your clearing house association and make some regulation which you will all live up to; why not make a reasonable charge for all the services you render? In our town we agree on the amount and charge each customer on his check.

On this safekeeping proposition, we charge a dollar a thousand on bonds. Every bank in town does it. We try to make a reasonable profit on all the services we render to our customers in our town, disregarding the size of the balance. In a few cases we pay interest on the commercial accounts. The majority of those are carried without any cost so far as interest is concerned.

MR. DJORUP: How many banks do you have that are not in the clearing house in your city, or are all the banks in the clearing house?

MR. DRESSLER: I think there are probably two that are not regular members, but every bank is an associate member and must live up to the rules.

MR. DJORUP: In a city where they have only a certain number of banks in the clearing house they are afraid that the business will go to the non-clearing house banks; it is very hard to regulate unless they all co-operate.

CARL W. HUMMER (American Exchange Bank, Canton, Ohio): In case they do not take up a note at maturity, we have instituted a charge of twenty-five cents for every notice sent thereafter, within a reasonable time, until it is taken up.

THE CHAIRMAN: Is that a condition expressed in the note itself?

MR. HUMMER: No, that is written on the notice of maturity. We do make a service charge of twenty-five cents for every past due notice sent. Usually those things don't go more than a week when that charge comes in. They will come in much faster.

MR. MCARTHUR: We follow that same plan.

MR. SMITH: May I suggest that that is a bad proposition, because if you keep a note running continually the borrower is going to be satisfied to pay twenty-five cents a week. I know I should if I had a thousand dollar loan.

THE CHAIRMAN: These charges are in addition to the interest, I understand.

MR. HUMMER: Yes, in addition.

MR. BROWER: I suppose you have reference to discount notes altogether. Our clearing house rules in Winston-Salem say fifty cents a day on every day that they remain unpaid.

THE CHAIRMAN: I know of a bank that makes a charge such as Mr. Brower stated, of twenty-five cents for each day that the note remains past due, in addition to interest, and thereby minimizes its past due list.

MR. DRESSLER: How do you do that if a man objects to it and the charge is big enough and the note small enough to produce usury? It might produce that situation.

THE CHAIRMAN: Mr. Brower, what is your experience in that?

MR. BROWER: They pay them pretty promptly or renew them. We have had no trouble at all along that line. Before we put in that charge, it was approved by our attorneys. I think it is all right so far as that is concerned.

THE CHAIRMAN: Then your attorneys probably interpreted that as a charge collected for services rendered.

MR. BROWER: That is it altogether—collected for a service. It is not interest.

THE CHAIRMAN: If that interpretation could be placed on it, you probably would be safe under the usury law.

MR. MCARTHUR: There is one point that I have not heard any one mention. If your customer does not carry a balance equal to twenty per cent of his loans, does any one charge him on the deficiency in balance?

CARL C. MILLER (First National Bank & Trust Company, Port Chester, New York): It has been our experience that we do have difficulty in getting some of these customers to carry sufficient balances; when they come in to make the loan, they give you all kinds of good promises, but very seldom live up to them. To overcome that, if a man wants to borrow \$5,000, we give him a loan of \$6,000 and take \$1,000 on certificate of deposit. We have our balance automatically and we don't pay him any interest on the certificate. That has worked out very satisfactorily

with us. We have never had any complaints on it, and at the present time we are carrying quite a few thousand dollars in our portfolio in just that type of certificate.

WILFORD GRADEL (Northwestern Trust Company, St. Louis): Where the investment division of a bank is only a separate department, what in your opinion should be the proper attitude of an officer or an executive as to selling bonds to savings depositors? Should it be an active campaign or should he be passive in his action toward savings depositors?

MR. NIEWEG: I should say passive, myself. What do some of you gentlemen think about that?

MR. MCARTHUR: In our bank we do not try to sell bonds to many savings customers. The only thing we do along that line is this. If we think we are going to lose a good account, we take them up to the trust department and try to sell them a participation in a mortgage.

PAUL H. HOHMAN (Bank of California, San Francisco): How do you prevent people from withdrawing their money from the savings account and putting it into building and loan?

MR. DRESSLER: We have the answer to that in our town. We had building and loans there for many, many years. This last year they got into difficulty. Now the building and loan customers are trying to get their money and cannot get it, so they are coming down to our commercial banks and trying to borrow on their savings and loans. I think when this thing is over, we will not have any trouble like that.

MR. THOELE: On returning checks "not sufficient funds," we make a charge of twenty-five cents for each item that is returned.

MR. NIEWEG: There is a movement on foot among the members of the clearing house of Philadelphia to get the clearing house association to adopt a rule making it compulsory for every member bank to charge fifty cents for each check returned.

MR. DJORUP: A number of banks in New York charge a dollar for every item.

MR. MCARTHUR: We charge a dollar.

THE CHAIRMAN: Who has another money making tip?

MARION S. BURDETT (Walker Brothers Bankers, Salt Lake City): As a savings tip, I might say that a few years ago we printed an advertisement on the reverse side of our deposit tickets, eliminating the possibility of customers using them for scratch pads. We cut our cost of those deposit tickets down to 33⅓ per cent of what they formerly were.

MR. MILLER: I have found out from my experience that one of the best ways of saving money, which is just as important as making money, is on our stationery, and that is obsolete forms. You will have representatives come in from all kinds of printing concerns and they will offer you a price. They will say they will give you 5,000 for so much, or if you take 10,000, the price will be so-and-so. The first thing you know they will be talking in such large numbers and quantities that you will feel you want to take advantage of that low cost; but it isn't always advantageous, when you stop to figure the amount of money that you have tied up on your shelves in stationery which is perhaps going to be obsolete at some future date.

If you keep your stationery down to about four or five months' need,

put a man in charge of it who understands something about the handling of it, and don't let everybody mess around with it, you will find a saving. The prices will be a little bit higher for the smaller quantities, but I think you will find that it will be made up by the saving in spoilage and obsolete forms. That has been our experience. I handled stationery for some time, and it was my experience that we did save money in that way.

I think one of the most important ways to save money is through your credit losses. We have in our community a clearing house association. I presume that in a number of the communities you have the same thing. If you haven't, there is an idea. All the banks in the county have united in a clearing house association and we have a system there whereby we report duplicate borrowers of over \$500. If a man comes into our institution and borrows \$500, his name is put on a card. There is no amount mentioned, but it is simply sent to headquarters, and the man in charge of the office there checks over to see if he is borrowing in any other bank. If so, he reports back to us that he is borrowing in this bank or in another bank, and we very often find out that the man is borrowing not only from two or three different banks in the same town, but that he will go out into the county in different towns and get large extensions; in many cases he has sworn to false statements.

We have found in some cases that we have been encouraged to decrease lines of credit owing to the fact that the men have spread their credit facilities so far. I know of one or two cases at the present time where, by this organization, we have perhaps

saved money which would probably have been a credit loss.

I have traveled around to some of the banks and very often I have seen different departments. They will have over in one corner the commercial tellers, and on another side savings accounts, and elsewhere Christmas clubs and vacation clubs and so forth. You will perhaps see a line-up of people over by the commercial tellers and see the rest of the tellers doing nothing. That is a very bad advertisement for the bank. The way we have gotten around that is, we have made our tellers actually a unit system. No matter what window a man steps up to, he can get practically any service that he desires. A few years back, we did have this same system of dividing up the departments, and when we brought in this unit system, we found that we were able to turn out the same amount of work, give better service to the customers, and eliminate two tellers. This may not work out to advantage in all banks, but I think in small banks—I call ours a small bank, we employ about forty-five people—it works out very advantageously. After all, it doesn't make any difference what window the man goes to; he can go to the savings window and get his check cashed or he can go to the Christmas club window and make his savings deposit; all the money is coming into one place and the tellers are placed there for the purpose of serving the public. If it were not for the public, the tellers would not be there. While it may not be advantageous for some banks, I think in a good many of the smaller institutions it will be an advantage.

MR. MCARTHUR: I should like to ask a question regarding that

county clearings plan. In reporting the names to the clearing bureau, do you report the names on notes which are brought in by your own customers as receivables?

MR. MILLER: Yes, we do. We report direct liability and also indirect. For instance, we have two colored cards. We have a white card that is nothing more or less than a plain card, and all we do is write the man's name, address, and his type of business on this card. That is sent in. In the event that I discount your note, I put down on the pink card my name, discounting your paper, and in that way we keep a cross index all the time. It works out very satisfactorily.

MR. DJORUP: I also should like to ask a question. You talked first about stationery and printing. Do you have competitive bidding?

MR. MILLER: Oh, yes.

MR. DJORUP: Many banks fall into the habit of ordering certain stationery and certain supplies, irrespective of the price that ought to be paid.

MR. MILLER: I have seen stationery on shelves of banks and just

as a matter of information I say, "How do you find their service?"

"Oh, we have never had any complaints. We have bought there twenty-five years."

"We simply send down and say, 'Make up a hundred thousand checks,' and that is all there is to it."

I am not going to quote figures, but I know that by shopping around for prices, you can easily get the same quality at one-third less.

Another plan we have used in connection with stationery is a unit price on check books. I think that is getting more and more general, but there was a time I know in our institution when we would pay so much to have the checks made and after that, pay so much to have 150 checks printed, a little bit more for 200, a little more for 250, and so forth, and a little special printing was extra. You never knew just where you stood. We have gotten it down to a unit basis now and I think our cost of checks for any size book, including the printing, is about \$1.47; at times I have seen those books run up to \$2.40 and \$2.75.

Bank Administration

Real Estate Loans

By A. C. TOSCH*

ASSISTANT SECRETARY OF THE CONTINENTAL ILLINOIS BANK AND TRUST
COMPANY, CHICAGO, ILLINOIS

Address before the Denver Departmental Conference

A bank's policy in regard to the making of real estate loans should be based upon a thoughtful consideration of many factors. Among these, the locality in question is a point to think about, as is the type of building erected on the property; and the method of appraisal used is vitally important. Moreover, the bank must see to it that the services which the investor in its real estate loans has a right to expect are not gratuitously rendered.

"If the demand for loans by borrowers and investors justifies the creation of a real estate division, a careful study must be made of the possibilities of earnings and the costs in conducting that business, as it will have to be operated in competition with many agencies through which funds are available for real estate mortgage loans."

THE purpose of this paper is to discuss the subject of Real Estate Loans from the standpoint of the real estate loan division or department within the bank; the justification for maintaining such a department; the policy to be pursued in the making and selling of loans; the services to be rendered, both to borrower and to investor; the profits which may be expected from such a department; and the liquidation of excessive loans or real estate acquired through foreclosure.

Demand by the clientele of the bank, both borrower and investor, and the profits which can be realized from the operation of such a division will be the determining factors as to whether or not a real estate loan department should be maintained. If the bank is in a residential community and its depositors mainly residents thereof, there will be a demand

from those depositors for financial aid in the construction and development of homes and business properties, and the bank also will be interested in the development of that particular community. The larger banks, located in the city's financial center, having a great volume of savings and commercial business, will be called upon by their customers for financial aid in the construction of similar projects, as well as for the investment of funds by their investors, and will undoubtedly be required to extend their operations over a larger territory.

If an institution has a trust department, it will acquire loans and properties through estates, will undoubtedly make or purchase real estate mortgage loans for the investment of trust funds, and must maintain an organization to service properly these properties and loans. The real estate division of a trust department operating

* Because of a severe cold, Mr. Tosch, although present, was unable to deliver his speech, which was read by William H. A. Johnson, of the same bank.

solely for the purpose of procuring and caring for loans is not looked upon as an earning department, since the service is included in the fees charged for administering the trust and a separate fee cannot be charged for this service.

If the demand for loans by borrowers and investors justifies the creation of a real estate division, a careful study must be made of the possibilities of earnings and the costs in conducting that business, as it will have to be operated in competition with the many agencies through which funds are available for real estate mortgage loans.

POLICY IN REGARD TO THE MAKING AND SELLING OF LOANS

In the making of loans, careful consideration must be given to the territory in which to operate; the kind of loans to make—whether on residential, apartment, or business properties; the type of construction; and the method of financing—whether the loans shall be straight term or amortized.

An institution should confine its operations to its own locality and to the demands of the community and its customers. If the demand by borrowers should exceed the investors' demand, the bank should carefully limit the funds which it will place in this class of security until the proper outlet is procured before accumulating any quantity of loans. The correspondent banks with which smaller institutions may carry accounts will assist in a measure on providing a market, by purchasing the loans for investment of banks or trust funds; but they will have to look for

a market mainly to individual investors and to insurance companies.

The method of appraisal in the making of loans is an all-important matter. Usually the policy is to loan a certain percentage of the valuation determined by the lender's appraiser. The appraiser, in arriving at the valuation, will first determine the value of land in the locality and then the costs of construction. This is one of the reasons why a bank should confine its operations to its own locality, inasmuch as its official personnel will naturally be more familiar with values and with the cost of construction of buildings in that particular territory. However, this alone is not all that is required. An appraiser must be a man of vision, determining whether or not a given loan is the proper kind to make—whether the type of construction is the one best adapted to the neighborhood; and whether there is a demand for that kind of property now and whether such a demand is likely to continue.

A loan is often requested by an individual who desires to build a home suiting his particular needs, where the cost of construction greatly exceeds the cost of the other homes in the community. In such an instance the same percentage of value for loan purposes could not apply, inasmuch as, should trouble develop, the locality would not attract the individual who could afford that type of home. If the loan is on a building constructed to house a particular type of business—what is called the one-purpose building—the cost may have no relation whatsoever to the amount which could be realized from such property should it become necessary to take it over and convert it to some other use.

In the appraisal of apartment buildings, apartment hotels, and business properties, valuation of land and cost of construction should be secondary, as the net income to be derived and the possibilities of income to be received during the useful life of the building are of prime importance. In the proper financing of any such project there are many questions to be considered, but principal among them are these: Is the property the right kind for the neighborhood? Is there a demand for that type of construction; and, if so, what average net annual income can be realized over a period of years, making proper provision for decrease in rents and obsolescence of building? The net earnings, thus capitalized, will be the proper basis from which to arrive at valuation, if that be less than the cost of construction.

A change has taken place in the method of farm land appraisals. A certain percentage of the selling price of land was formerly the basis on which loans were granted, with perhaps a restriction that such loans should not exceed a certain amount per acre. Those in the farm mortgage business are familiar with conditions which have existed since 1919, and know that this method has proved unsound. Generally speaking, in the fall of 1919 land in the Middle West had reached its peak price. The increase was gradual during the period from 1905 to 1914, and during that time the percentage method of granting loans caused no trouble; but with the war came higher prices for food products, which meant larger profits for the farmer. He, in turn, purchased more land, giving no thought to the fact that the future would bring with it lower prices for com-

modities; and today in many instances he finds that he is unable to carry on, because the income from his farm is insufficient to take care of taxes and the interest on his mortgage indebtedness, not to mention the capital investment he may have therein. What is of prime importance to the appraiser of farm lands today is the productivity of the land—how much the farmer can produce in crops under ordinary conditions; what is the average price over a period of years which he can hope to receive for his products. Once that is known, the income from that farm may be capitalized to determine the value of the farm itself.

CHIEF CONCERNS OF THE INVESTOR

In the distribution of loans, the principal outlets are the individual investors, the correspondent banks, and the insurance companies. Investors in purchasing loans are primarily concerned with type of loan, margin of security, marketability, and the service which the loan company will render in connection with the loan. At the present time there seems to be a greater demand for the small individual loan, and perhaps this can best be explained by the fact that the investor is demanding a loan within territory where he has some idea as to the value of land and buildings. He inspects the security and considers it with the realization that, should he be required to take over the property, he can convert it to his own use; or he is familiar with the rental which that type of building will bring under normal conditions and can determine for himself whether that income would bring a satisfac-

tory return on the amount invested. Many mortgage investors have lost faith in real estate mortgages as investments, because of the unfortunate experience they have had recently with real estate mortgage bonds. In this type of investment the investor must usually rely entirely upon the company which makes the loan. Had these companies considered the demand for the class of construction, and more closely analyzed the possibilities of income over a period of years, rather than the income which could be received during the most advantageous rental period, the trouble possibly might have been avoided.

The investor is also concerned with the marketability of a real estate loan, as often he finds that he needs his funds for other purposes, and the only source to which he can look for a sale is the company where the loan originated. Oftentimes, in order to effect a sale, a promise is made in regard to repurchase, and in some instances a written agreement is given to repurchase a loan on a 1% repurchase charge. Such a policy or statement is likely to cause trouble. In a high interest market loans will flow back, or, if people become dissatisfied with that type of security as an investment, they will request repurchase. It is true that some sort of market must be maintained, but it should be sufficient to make a statement to the effect that, provided conditions and rates remain the same and there is a reasonable market for that class of loan at the time, the company will repurchase it at a reasonable charge.

SERVICES WHICH THE INVESTOR MAY EXPECT

The service which an investor can

rightfully expect during the life of the loan is for the company to collect and remit the interest, to see that taxes are searched annually and that the insurance is kept in force, and to collect the principal as it matures. It is the policy of some companies to advance interest to investors as it becomes due, but this practice should be avoided. If interest is advanced, notice should be given to the investor each time it is advanced, with a definite understanding that if, within a reasonable length of time, the money cannot be collected from the borrower, the investor will make reimbursement. In the searching of taxes if it is found that they are delinquent, every effort should be made to effect payment by the borrower; but if it becomes necessary to purchase the certificate at tax sale, the investor should then be notified, and he should advance these funds so as to protect his lien. Insurance covering the buildings in the proper amount should be kept in force, and, at the expiration, renewal policies should be procured. These services an investor may rightfully expect, but when it comes to the advancement of funds so as to protect the lien, he must stand ready either to make such advances or to reimburse the company which is advancing the funds for him.

In the matter of taking over security, real estate mortgage buyers seem to take an entirely different view from that taken by bond buyers. If a real estate mortgage becomes delinquent, the investor usually expects that the firm which sold it to him will stand ready to relieve him of his investment; and when selling loans the investor should be impressed with the fact that if trouble should arise he will be expected to take over the se-

curity himself, inasmuch as he is getting an increased rate because of this additional risk.

SHOULD THE BANK MAINTAIN A REAL ESTATE MORTGAGE DEPARTMENT?

Up to this point we have considered generally the investor's problem and the banker's problem with respect to the underwriting and offering of real estate mortgages. We should now turn to a consideration of those factors which determine whether or not a real estate mortgage department should be maintained as a part of the bank.

The determining factor as to whether the bank will maintain a mortgage loan department is the profit and possibility of profit which can be derived from such a department. The principal source of income is the commissions received from the borrower; but is it known whether these commissions cover the cost of production, of distribution, and of services, inasmuch as these costs are constantly changing during the life of the loan? Is any consideration given to the costs which will result from the servicing of properties when loans get into difficulty? In this highly competitive market the commissions received on small loans oftentimes fail to cover the cost of making them; yet loans are made because of the demands on the bank by borrowers and investors. Should there not be a minimum charge on all small loans to cover at least the cost in connection with the handling, and allow a reasonable profit? If a sufficient amount cannot be collected from the borrowers on this class of loan in the form of commissions, and if the in-

vestors demand such loans, they should expect to pay a premium, or else accept the loans on such a basis that the company making the loan can retain a portion of the interest as reimbursement for these costs. The ordinary individual investor in real estate mortgage loans insists on a 6% rate, but if he expects to get the highest grade of loan, he must be satisfied with a return no greater than that accepted by the numerous insurance companies and larger investors, or what he can get on other high grade investments.

In crediting commissions as profits, only the proportionate share covering the cost of initial service performed should be taken in the year in which it is earned. The costs of making and selling loans can easily be determined, as they are immediate. For the service to be rendered in the collection of interest, the searching of taxes, and the handling of insurance, a proportionate share should be reserved and taken as a profit as it is earned. If it is the policy of the company to protect its loans and service them if they get into difficulty, receiving therefor no compensation from the investor, then a certain percentage of the commission received at the time of making the loan should be set aside as a reserve to cover this expense.

SERVICING OF DEFAULTED LOANS AND DISPOSITION OF PROPERTIES ACQUIRED

The policy of some of our mortgage houses has been to protect their investors and take up loans when foreclosure became necessary, either because of unwillingness to admit error in judgment or for fear that they

would jeopardize their future business. A loan should be serviced to the date of its payment, or, if it becomes necessary to institute foreclosure proceedings, it should be serviced during that period; but, when the title finally passes, the property should be taken by the investor. If the mortgage house takes over the property, it is presented with the problem of liquidation. Too often a fear of capital loss causes the property to be carried for a period of time in the hope that the market will improve. In order to realize the most out of the liquidation of any particular type of security, the demand and possibilities of demand for that particular kind of property must be carefully considered but generally the policy should be to liquidate as quickly as possible. There is no excuse for gambling as to the speculative future value. If the income derived from the property does not warrant the capital investment, the property should be disposed of at a price somewhere near the capitalization of its earning power, and effort should be devoted to recouping losses through the profits from new business, avoiding in the future practices and methods which may have resulted in losses in the past.

In the liquidation of excessive loans, make your demands for reduction of principal reasonable, so that they do not work a hardship on the borrower. Because of his pride, his willingness to pay his obligations, his desire to protect his equity, and his ability to handle his particular type of business, he will be more apt to be successful in the orderly liquidation than if the mortgagee or investor took over the proposition.

The liquidation of residences and

two-flats is simple, as there is a fair demand for such properties, and ordinarily a large amount of capital is not needed to finance the purchase. In the case of apartment and business property the initial payment is comparatively large, and the purchaser is confronted with a problem of management. The income which can be derived, then, will be the sole determining factor in placing the valuation. It is with this class of property that the mortgage houses experience most of their difficulty, and it requires a complete and competent organization to handle the situation in the most economical and constructive way.

We shall, however, experience very little trouble in the real estate mortgage business, if we observe certain precautions. In the making of real estate mortgage loans, both farm and city, we should refuse to be misled by abnormal conditions, also we must take into consideration the demand for certain classes of property and the income to be derived therefrom under ordinary conditions, and, to arrive at values we must properly capitalize income, and confine our loans to, say, 50% of the appraised valuation, where the borrower has just as much at stake as the lender.

Discussion

CHARLES H. DIXON (Commercial Bank of Spanish Fork, Spanish Fork, Utah): In determining value through income, I should like to know how many times net income value should be placed on income-producing property.

MR. JOHNSON: On about a 6% basis—your net income multiplied sixteen times. That is a striking figure. In some communities that would not

be a fair return, but, to give an average figure. I should say 6%. In some cases you might do it on an 8% to 10% basis, depending on the community. In a boom town you would do it on one basis, and in a settled community you would have to do it on another.

F. LLOYD MONROE (Hibernia Bank & Trust Company, New Orleans, Louisiana): You spoke about banks in the smaller communities and the larger cities making loans solely in the districts in which they do business. Don't you think there is a greater advantage in diversification of loans? What I have reference to is the larger institutions, which make a large number of loans, carrying for their own account and issuing trust notes or something like that. Don't they give their customers more security by diversifying these notes out of different communities or even different cities?

MR. JOHNSON: As a matter of personal opinion, I think you can get the same diversification by taking loans in your own community and throwing them together and issuing certificates against them. The difficulty, unless you go into that business very extensively, is the expense connected with it. For instance, with a Chicago house trying to do business in Denver, the expense of sending people out here to make appraisements and getting local appraisalment, would eat into commissions. You would have to do a very substantial business to justify that expense.

Mr. Tosch also suggests that when a bank gets out of its own general community, which doesn't necessarily mean the city limits wherein it is doing business, but may mean an entirely different trade territory, it is not fa-

miliar with the demands for property of a particular type. It can't rely on its own judgment and has to take the opinion of local people, who are apt to be prejudiced and have too bright a view of what the city is going to do. You don't know construction costs. A number of factors enter in. That has been the cause of some losses. Local people have been too optimistic about how big a movie house the town could support, for example.

GEORGE V. H. BROWN (Bank of Italy, First & Pine Branch, Long Beach, California): On these real estate loans made over a period of, say, five years, is there any principal payment after the second year? Suppose that a loan is on a large apartment house, which, you say, has perhaps a life of twenty-five years. Each year the apartment house depreciates. After the first or second year is there a payment of the principal?

MR. JOHNSON: That was one of the suggestions made. The expression "term loan" wasn't necessarily intended to mean a straight five-year loan. In long time loans on apartment property or theatre property (anything you could call business property in the broadest sense of that word; not just mercantile property, but property operated for a profit), you should have pre-payments that will equal or exceed the depreciation of the property. If you have a building good for twenty-five years, you have a certain percentage of depreciation every year, and the loan should be paid off to meet the depreciation. You have, or at least we have in Chicago today, good properties, substantially built, which are being outdated, and a great deal of money has to be

put into them to install mechanical refrigeration and remove the old-fashioned chandeliers, to put in side brackets, substitute French grey for quartered oak, and so forth. The building is good for twenty-five years, but it hasn't a rentable life of twenty-five years.

MR. BROWN: Is it advantageous to have a borrower pay additional fee for the tax and assessment service, to save the bank from searching the record for delinquent taxes and payment on street assessments, and so forth?

MR. JOHNSON: I would say in general, without trying to dodge the question, that that might be a local condition. The loan houses in Chicago engage tax buyers to search for delinquent taxes. It costs less than a dollar a property. So there wouldn't be much advantage in trying to have the borrower pay that charge. It would cost you more to collect it than to pay it out of your own pocket.

If you had a peculiar situation where the taxes were scattered among different collectors and the expense was large, it might be well to take care of them on some basis of reimbursement by the borrower.

EDWARD F. LE BRETON (Hibernia Bank & Trust Company, New Orleans): Isn't it perfectly feasible to say to your borrower that he must furnish you evidence of payment of tax? That is our custom in New Orleans. Our mortgage company does considerable business. We simply say to the borrower that he must show us evidence that the taxes have been paid. He has to furnish that himself.

MR. JOHNSON: Personally, I would rather use the system of having a tax buyer or some one familiar with the tax situation examine the books at the delinquent date, than

check up to see whether Bill Smith brought in a tax bill for examination. You have to talk to Bill Smith over the counter; whereas, if you have some one looking at the delinquent books, you can report these taxes as not paid, and they must be paid to keep the loan up. Otherwise he has to come to you with the receipted tax bill, which, to my mind, is more of an operation than searching records.

MR. LEBRETON: I have one more question. You mentioned purpose buildings. Just how far will you go in making loans on a one-purpose building—a theatre, a specialized apartment building? Where would you stop? Would you go to a warehouse or a factory building? Where is the line you would draw on one-purpose buildings?

MR. JOHNSON: I wouldn't consider an apartment house strictly a one-purpose building, for the reason that there is always a demand, or nearly always, for residential property, but, when you get into the theatrical proposition, you are dependent on the inability to convert a theatre into anything else. You can make an apartment house into several things. For instance, I am staying in a hotel that was an office building at one time. If you have a garage or a theatre building, you have to be very careful in your loan, because, if they flop, you cannot use them for anything else. When you get to a factory building, you are practically not making a real estate loan. You are going into the commercial banking business. It is not, strictly speaking, a real estate loan, because, if you have something that is laid out for a foundry, for instance, you are going to have a hard time to get a manufacturer of cheese to go into it. You

have a location proposition at the foundry. The property is located for foundry purposes and may not be good for anything else.

Personally I would not consider that the factory proposition is in the real estate class from the strict point of view of real estate loans. That is a rather special proposition. On apartment buildings I should consider it a residential loan, but on theatres and stores, you should use great caution and make lower percentages and require higher amortization or pre-payments than on other types of buildings.

ALAN WARNER (Chatham Phoenix National Bank and Trust Company, New York): You speak of basing the income, not on the best years, but on what you may expect to be the years of life ahead of the project. At a time like this, when we see commodity prices slumping badly, when we expect to see revision in rents, how far do you discount that expected drop in rentals of general properties, residential and otherwise?

MR. JOHNSON: Those are things that you cannot set any accurate gauge on, except that in high rent periods people have been too prone to accept those rents as being permanently fixed. In figuring the rental

return, you should allow a reasonable amount in figuring obsolescence of the building to cover possible lower rents on account of the change in type of construction, or a situation such as we are probably running into now, where certain types of buildings will be in less demand. That would be included as one of your costs in writing down your rents. Take today's rent, but do not fail to consider those factors.

MR. WARNER: You have seen a tremendous write-up in values due to increased cost of construction, beginning with, say, 1914 or 1915. How far do you think it prudent to consider that there will be a write-down in cost of construction, and, therefore, in the value as to income purposes of all existing buildings now?

MR. JOHNSON: I will be frank and say that I cannot answer that question offhand. Probably the nearest thing you could come to is the suggestion Mr. Tosch made in his paper on farm loans—to take an average period; go back of 1914, and possibly add in some of the high cost periods since then, and take an average of the two periods. That would give as near a thing as you could get under present conditions.

A Sound Loan Policy

By ALFRED E. ROBERTS

CASHIER OF THE CALCASIEU NATIONAL BANK OF SOUTHWEST LOUISIANA,
LAKE CHARLES, LOUISIANA

Address before the Denver Departmental Conference

In this genial and thoroughly human article Mr. Roberts confronts the difficulties of the bank's credit man. He lays down three fundamental rules which he considers will help to establish a sound loan policy for the bank:

1. Liquidity of loans needs to correspond with character of deposits.
2. Average rate of interest received should be as high as possible without any sacrifice of safety.
3. Intelligent analysis of requirements of customers must be made.

To the traditional three C's of credit investigation, Mr. Roberts adds a fourth, Conditions, and besides demanding of the loaning officer a policy of diversification which will help to neutralize unfavorable conditions in the business world, he requires that this executive be "reasonably well informed, in advance, of the acts of Providence."

WHEN an individual goes into business, everybody knows that he is doing so for the express purpose of making money for himself. Because banks are regarded as semipublic institutions, however, it is not generally understood that the chief object in their organization and operation is to return a profit to their stockholders.

During the past few years it has become increasingly difficult for all businesses to earn satisfactory profits, and most banks have fared no better than other commercial undertakings. To meet this condition of narrowing margins of profit, executives are endeavoring to increase the total revenue of their business, reduce expenses to a minimum, and eliminate credit losses.

Many banks have been able to increase their income through instituting proper charges for services ren-

dered. Even with this additional source of revenue by far the largest item on the bank's earnings statement is "interest and discount on loans."

There never has been a time when interest rates were high enough to permit of profitable operation that there was more than a very small loss ratio on loans. With a long term trend of interest rates slightly downward, and the cost of doing business apparently ever increasing, losses on loans must be kept at a minimum.

There is no way to outline in detail a cut and dried plan for choosing credit risks, but the bank with a sound loan policy will give proper weight to these essential requirements:

1. Liquidity of loans needs to correspond with character of deposits.
2. Average rate of interest received should be as high as possible without any sacrifice of safety.

3. Intelligent analysis of requirements of customers must be made.

LIQUIDITY OF LOANS

Irrespective of the apparent stability of its line of deposits, every well managed bank should have sufficient primary and secondary reserves. With such reserves it is proper to consider the character of deposits in determining the desirable distribution of funds among the several types of loans usually contained in a bank's portfolio.

An institution with a larger percentage of time deposits than the average, can safely loan a greater amount of its funds on longer terms than can one with a large part of its deposits payable on demand. Public funds represent the most unstable form of demand deposits and should be invested in only the most liquid kind of loans or securities.

A recent classification of the loans of a large number of the banks of the country showed:

Unsecured—

one or more names 54.8%

Secured—

stocks and bonds 18.9

personal securities 16.0

real estate 10.3

Of these loans 32.1% were eligible for rediscount with the Federal Reserve banks.

Conditions vary in different localities, but neither local conditions nor the character of deposits would justify any considerable variation from the average disclosed by the classification made.

AVERAGE RATE OF INTEREST

Since interest and discount furnish

the chief source of income, it is of course necessary that the average rate received be sufficient to return a profit to a well managed bank. Interest rates are, in a broad way, governed by the supply of, and the demand for, capital, and are affected by the state of bank credit and by current business conditions.

The pure rate of interest is the price paid for capital with no premium for risk. If analyzed, the rate of interest charged by banks would be found to consist of a basic amount of pure interest, a charge for the average cost of handling loans, and an additional amount commensurate with the risk involved. As the pure interest rate and the cost of handling loans vary only slightly, high interest rates can be attributed directly to the amount included because of the risk involved. Since this is the case, high interest rates are apt to indicate greater business risks rather than to assure larger profits.

Requiring proper average balances is a legitimate indirect method of securing a higher return on loanable funds. Such a requirement is also advantageous to the customer, if he is impressed with the desirability of having sufficient funds available to take care of his current needs. Credit losses in any business are worthy of a few tears, but for the banker they are positively heartrending.

If the average rate of interest received on loans is 6%, which is high for many banks, the gross profit on a loan of \$1,000 is \$60. After deducting operating costs, not more than \$20 of this amount can be counted as net profit. This means that if one borrower is so inconsiderate as to fail to repay his loan of \$1,000, an amount equal to the net profit on

\$50,000 of loans has been lost. Do you know of any other business or profession where it is necessary to judge correctly fifty times out of fifty in order to earn a legitimate profit?

With so narrow a margin of net profit it is essential that every loan meet the test of our old friends Character, Capacity, and Capital. Since another "C," Conditions, often affects business, it is highly desirable to follow a broad policy of diversification in making loans. To do so will help prevent the advancing of too large an amount to a single borrower, to one industry, or to a limited area.

In good times most good loans are thoroughly liquid. With a slowing up of business activity, however, the ones which are first to become frozen are those commonly classed as capital, investment, and accommodation loans. Because of their lack of liquidity the total of these classes should be kept as low as possible, irrespective of their ultimate goodness. Remember: the desirability of a credit risk is determined not only by the desire, but by the ability, to pay; thus the "desire-ability."

INTELLIGENT ANALYSIS OF CUSTOMERS' REQUIREMENTS

Every credit man has a feeling, at least occasionally, that some of his customers do not fully appreciate what the bank is doing for them in making certain requirements as a basis for their loans. Many borrowers, and would-be borrowers, are certain that the average credit man is a soulless individual who does not understand their needs, and derives his greatest pleasure from saying "no." Both credit man and borrowers need

to realize that danger signals for the bank are just as surely danger signals for the customer, and should be regarded in that light. Such a realization by both sides will stamp the credit department not only as custodian of the bank's loanable funds, but also as a most valuable source of information for the customer concerning good business practice.

With economic conditions constantly, and often radically, changing, there are few enterprises which are not, at some time, affected by one or more of the common business ailments. The true test of keen management is not the ability to avoid all of these difficulties—some are unavoidable—but rather to recognize what is wrong, determine the corrective measures necessary, and put them into effect.

CAUSES OF BUSINESS FAILURE

Bradstreet's analysis of the causes of business failures in 1929 lists lack of capital as being responsible for 37.2% of the total number, and incompetence as causing 31.4%. It is comparatively easy to determine from the statement of a prospective borrower whether or not the invested capital is sufficient for the current needs of the business. It is not always so easy to convince him that the amount of his net worth places a more or less definite limitation on the volume of business which he can carry on with safety.

Lack of capital can be overcome temporarily by unusual rapidity of sales and collections, but both of these factors are seriously affected by slackening of general business activity. With such a condition existing, an overextended position results.

Being overextended is a serious matter for any business, but it is acutely so for most smaller enterprises. This is due to the increased difficulty usually incident to their obtaining necessary funds, either in the form of additional capital or of larger credit lines.

Many firms start out without enough capital, believing that profits from operations will bring relief. Experience has taught that even satisfactory profits left in the business are no more than sufficient to take care of a normal growth. Profits are so hard to make that any one contemplating starting in business should do so only when well fortified with a sufficient investment to withstand unlooked for reverses.

Competency of the management is a more difficult question for the credit man to determine. Unless there is a past record of successful operation under similar circumstances, he must rely chiefly on his own judgment of the ability of those in charge. To form an intelligent opinion, the credit man will have to question the executives in such a way as to determine their knowledge, not only of their particular business, but of general business practice as well. This means that the competent credit man must be well versed in good business practice and have some knowledge of the type of business under consideration. Sometimes apparent ability of the management in general business procedure is more than offset by lack of experience in the particular line of endeavor contemplated.

Probably the next most serious business ailment is overinvestment in fixed assets. Its seriousness arises from the difficulty of correcting it. Irrespective of their cost and operating value to a going concern, most fixed

assets cannot be sold except at a considerable discount. Plant expansion should be made only when justified by anticipated sales volume based on normal conditions.

There are other business ailments, of a less serious nature, which are comparatively easily corrected if discovered in time. Small average balances are not conducive to creating a favorable impression with banks against the time when new loans or extensions are desired. More important still, all trade discounts cannot be taken unless ample cash funds are available. The lack of funds is more serious if it results from a poor collection policy.

Too large an amount of receivables is undesirable, because of the extra cost of carrying them. Since this condition usually results from lack of proper attention, there is the probability that some slow accounts will turn bad and so cause an unduly large loss ratio.

The merchandise inventory is the most difficult item to value correctly. It is subject to current price fluctuations, with the less stable classes varying the most. Few responsible merchants believe that they are really gambling when they overbuy in anticipation of price increases, but such is the case. The good merchant is the one who can supply practically all of the wants of his customers and yet have a minimum investment in merchandise.

PROBLEMS OF THE CREDIT MAN

Problems of every kind and description are constantly developing to test the ability of the credit man and the business executive in their solving. Analyzing and correcting them af-

fords the real thrill in business, but only those who are well qualified can expect to treat the ailments successfully.

A lawyer's client may hang or a doctor's patient may die, and he who has departed will be held responsible for his own misfortune. But if the blood of a creditor's business be so chilled by frozen assets that it ceases to flow, the credit man must share the blame.

The keen credit executive should be well grounded in the proper conduct of business in general, should have some knowledge of the characteristics of particular types of business, and should be reasonably well informed, in advance, of the acts of Providence.

Discussion

E. V. KRICK (American Trust Company, San Francisco): I should like to ask Mr. Roberts if he would care to express an opinion as to a sound loan policy on instalment paper.

MR. ROBERTS: Our own opinion is that with the instalment paper which we are handling, covering automobiles, radios, and similar things, we do not want to go beyond our knowledge of the credit risk of the signer of the paper, that is, the purchaser. We, of course, are fortunate in being located in a small town and being rather well acquainted with

all the people in our own trade area. We have stuck strictly to basing our extension of credit upon our analysis of the ones to whom they are selling, which would not be applicable in most cases, because people would not enjoy the opportunity of knowing everybody which we have in a small place.

MR. KRICK: Then you would look upon your credit risk more in the shape of unsecured credit to your borrower?

MR. ROBERTS: To a certain extent. We have not had experience along the other line.

EDWARD F. LEBRETON (Hibernia Bank & Trust Company, New Orleans): Mr. Roberts talked about pure interest and said that a percentage of it represented risk. I wonder if he has in any way determined in his own mind an average rate, say, of 6%. What would be pure interest and what would represent risk?

MR. ROBERTS: I believe that the pure interest rate is usually considered as about the rate of interest on American Consul Bonds, United States Consul Bonds, which varies slightly, but I believe the pure interest rate at the present time would be about 3% or 3¼%. The average cost of handling loans varies, of course. It would probably run from ¾% to 1¼%. That would be a rate of about 4½% for the pure interest rate and the cost of handling.

Farmer Loans

By THOMAS G. WILSON

ASSISTANT CASHIER OF THE BANK OF CONWAY, CONWAY, ARKANSAS

Address before the Denver Departmental Conference

The farmer has long been the Sick Man of America. A penetrating diagnosis of his financial ills, and a subsequent prescription for their cure, makes Mr. Wilson's paper a very valuable contribution to its subject.

He finds the main weaknesses of the farmer's position to result from overexpansion of the credit extended to him by various agencies; his tendency to reinvest surplus funds in fixed assets beyond his ability to carry; his ignorance of the cost of production; his perennial struggle with unpredictable weather conditions; his speculation on the unearned increment of farm values; the inelasticity in the demand for his products; and the individualistic character and slow turnover inherent in his industry.

The remedy for some of these conditions he sees in the newly created Federal Farm Board; in a more rigid limitation of capital loans; in the encouragement of thrift and diversification in farming; in governmental advice as to the proper acreage to plant; in a reduction of the cost of production; and in the treatment of the agricultural borrower on the same basis as his commercial brother.

AGRICULTURE has been recently defined as "an island of despondency surrounded by a sea of prosperity." In my talk on farmer loans I do not intend to play the role of a modern Moses and lead the way out of this agricultural slavery, but I will endeavor to enumerate the facilities of agricultural credit and the apparent causes of our present unsatisfactory agricultural condition, and to offer some suggestions which are to my mind steps toward a cure for our present ills, and ways and policies that we may follow to steer clear of these pitfalls in the future.

It is unnecessary, before this audience, to emphasize the importance of agriculture as our basic national activity, fundamental to all commercial,

industrial, and financial operations. It has been demonstrated, amply though painfully, several times during the past two decades that in America the stability of commerce and industry is closely interwoven with a prosperous agriculture.

A proper definition of credit, farm credit or otherwise, is, that facility which permits the use of funds not employed elsewhere, to bridge the gap between the beginning of production and actual consumption. The extension of credit implies that loans have been made, and therefore if loans are not repaid with reasonable promptness, they cease to be loans and become capital investments, or, worse still, potential losses.

In considering farmer loans—or, as I prefer to call them, agricultural

loans—we will first take up the facilities available to the farmer from which to derive whatever credit extensions he may have need for. For long time credit, or credit to be diverted into fixed assets, the farmer may borrow from the Federal Land banks, for a period of from five to forty years, at a very reasonable rate of interest. If a farmer needs funds with which to help pay for his farm, this is the source he should look to for credit, because, with the plan of amortization, the Federal Land banks in our twelve districts have worked out very practical methods for financing this phase of agricultural credit. For a while some of the Land banks expanded their credit rather rapidly and with a sacrifice of safety, probably; but I understand that now they are far more conservative in their loans and will make a loan on a farm only in the proportion justified by the record of earning from the farm land in question over the period of the past few years. In this way they are protecting themselves to a marked extent, for they can safely expect the average return of the past ten years from a farm to be a fair indication of the return to expect for the next decade.

Next we will consider the Federal Intermediate Credit banks as a source of credit supply for agricultural credit or farmer loans. The loans made by these organizations run from nine months to five years; these banks, operating in conjunction with the Land banks, were created to bridge the gap between the maturity dates of Federal Reserve paper and of Federal Land bank paper. Such branches of the agricultural pursuit as cattle raising benefited greatly from this source of credit, because

most cattle loans, of necessity, should run anywhere from one to three years, and, under the old credit system, cattle raisers had either to finance themselves or to trust to luck that they would be able to renew their loans at their due date, and this fact often caused them much embarrassment and financial loss. Then, also, many credit associations and banks have rediscounted their agricultural paper with the Intermediate Credit banks at a low rediscount rate, with a resultant saving in interest rate to the agricultural borrower, because the rate charged by banks so discounting their paper must not be more than 2% over the rediscount rate of the Intermediate Credit bank. There were many who did not believe that there was demand for such a financial institution when these banks were first authorized by Congress, some even thinking that they would seriously handicap the small country bank, but they have fitted in and formed their own unique field of financial service.

Next, the farmer, through his bank, provided such bank is a member of the Federal Reserve System, may have his paper discounted with the Federal Reserve bank, if such paper does not run for a longer period than nine months. Too much cannot be said for the service rendered by our Federal Reserve System in extending billions of dollars' worth of agricultural credit, when greatly needed, at much lower interest rates than we ever had before the establishment of the System. It seems to be easier to have agricultural paper passed on as eligible for rediscount than any other class of security, and for this reason member banks have rarely had any trouble in

having funds advanced for agricultural needs.

Then we also have the Joint Stock Land banks for advances of long tenure on farm paper.

Next we come to the commercial bank as a source of agricultural credit, and probably more money is advanced from this source than from any other. All country banks necessarily have a great part of their funds out on agricultural risks, and, in turn, their borrowings from the Federal Reserve banks and from their city correspondents are largely made to care for this class of credit. The farmer keeps his account with his nearest bank and forms a contact there that makes him look to this bank first for credit needs; and, as a rule, the farmer would rather borrow from his local bank, and pay a higher rate of interest, than look to what you might call an outside source for his credit. This brings up the question of the policy followed by the country banks in making these loans. Conservatively managed country banks seldom lend money for longer than one year at a time, and not longer than six months if it can be helped; and they should expect liquidation of the loan at the expiration of that time, because a bank with funds on deposit payable on demand cannot expect to have a great number of long time loans.

We might now take up the credit merchant and the individual capitalist as the other sources for agricultural credit. Usually advances by these agencies are made for a period of from ninety days to one year, and at a very high rate of interest. It seems that from past experience this class of lenders has found that a high interest rate is required to take care of the losses sustained from making these

loans. Some say that the oldtime credit merchant, who furnished everything the farmer needed in order to plant and gather his crop and even supplied food for his family as well, is a thing of the past, but there is still a great deal of demand for his functions. There are some classes of borrowers that never will be fit subjects for a bank to deal with, and I think the credit merchant is the logical source of credit for this undesirable bank risk.

Recently Congress has established the Federal Farm Board, which has at its disposal a revolving loan fund of \$500,000,000 with which to finance cooperative associations in the orderly marketing and distributing of their products, and this will in the future, I believe, be a source of great help to the agricultural credit field.

From the above credit facilities available for agricultural credit, or farmer loans, we can readily arrive at the conclusion that the crying need of agriculture today is not for more credit, but for some method of getting the farmer out of debt instead of forcing him further in.

REASONS FOR THE PRESENT AGRICULTURAL PRE- DICAMENT

Our total farm debt is now greater than ever before, and it is increasing by billions of dollars yearly. Admittedly our position is precarious. I would attribute the first cause for the unhappy situation to the fact that there has actually been far too much credit available for agricultural pursuits. Congress, in its eagerness to help out the farmer, has, through its various governmental credit agencies, extended too liberal a line of credit

to the farmer, and the commercial banks have done the same thing. About the worst thing that can happen to any industry—whether it be agriculture or the textile industry or the steel industry—or to any individual man, is to make it easy for him to involve himself in debt.

So we may surmise that probably the main reason for our present agricultural predicament is overexpansion of credit facilities; but there are many other contributing factors.

When a farmer has a good year and makes a very nice margin of profit, he will not invest his surplus funds in some line of secondary reserve, such as good bonds or stocks; but he will go out and buy the adjoining farm, or sell out and move to another place where he buys a larger farm; and he will then go back to his bank the next spring for a loan. This can be considered nothing more than a capital loan, and no policy is worse for a bank than advancing loans consistently, the proceeds of which are used for working capital by the borrower.

Still another factor has proved of detriment to the agricultural class. Perhaps no other industry has as many individual producers in it who know so little about their costs and therefore are cut-throat competitors of their fellow producers. Agriculture has not shared proportionately with other industries in the improved efficiency of its purely business organization, nor has it applied scientific principles and discoveries and inventions on the same basis. This is probably caused by the individualistic character of the industry and the resultant difficulty of securing cooperation and appreciation of the importance of these better business methods. Farm-

ers as a class are poor managers, and the improvements in production they have adopted, such as machinery and modern agricultural methods as presented to them by our agricultural colleges and demonstrators, along with increased taxes, have caused a tremendous increase in the cost of production, not offset by a similar increase in the market price of the product.

Weather conditions have played a great part in farm production. Suppose that only an average acreage, or even a reduced acreage, were planted and the weather conditions were very favorable: the crop would be an overabundant one for which there was an inadequate market; and when agriculture overproduces, unlike the manufacturing industry it cannot shut down and curtail production for a long period of time in order to let consumption create a new demand for its product.

Then, another cause of the agricultural problem of today is that buyers of land have been misled by the unearned increment of farm properties and have jumped in at peak prices and bought—much to their sorrow, and also to the sorrow of many banks which loaned money to them to purchase land at from \$400 to \$600 per acre and to pay rentals of from \$10 to \$20 per acre for the use of lands. When these faulty land values came back to earth, the drop demoralized agriculture as well as ruining many of our banks, especially in the post-war period, when we had one bank in every eight failing over the six-year period from 1920 to 1926.

Then the elasticity in demand for farm products is not so great as it is in some industries, and an exten-

sive advertising campaign or a reduction in price does not materially increase the demand. For instance, if the price of wheat were to fall fifty per cent from its present level, this would not greatly increase the consumption of its products; and this fact holds true for nearly all foods; but of course the demand for goods increases with such a drop.

Then, again, the individualistic character of agriculture precludes the large scale buying which is possible in other industries, and up to this time has not allowed very much large scale selling. The farmer must necessarily buy at a retail price, in small quantities, and sell likewise; his buying power is limited and his selling powers are limited, and therefore he cannot benefit from advantages reaped by other industries through these large scale economies.

When we look over a statement given us by an industrial concern or a merchant, we always see what the turnover is, and in many industries it is very high, but in agriculture the farmer can turn over his crop—which is his inventory—but once a year. This is a condition beyond remedy, because of the nature of agriculture. This fact forces the farmer to pay a higher rate on the capital used, because his loans are less liquid than those in other industries and are frequently more hazardous.

As you can see from the program, I am from Arkansas, where our chief money crop is cotton, and, as you know, the cotton situation has been much discussed. The other day I read an article which I should like to read to you; it is entitled Cotton.

"Cotton is the overcoat of seed that is planted and grown in the

southern states to keep the producer broke and the buyer crazy.

"The fiber varies in color and weight, and the man who can guess the nearest to the length of the fiber is called a cotton man by the public, a fool by the farmer, and a poor business man by his creditors.

"The price of cotton is determined in New York, and goes up when you have sold, and down when you have bought. A buyer, working for a group of mills, was sent to New York to watch the cotton market, and after a few days deliberation he wired his firm to this effect: 'Some think it will go up and some think it will go down. I do too. Whatever you do will be wrong. Act at once.'

"Cotton is planted in the spring, mortgaged in the summer, and left in the field in the winter.

"You can and you can't; you will and you won't. Be damned if you do, and be damned if you don't.

"Ten mills made a cent—but not cotton mills."

REMEDIES AVAILABLE

But now, since I have named the facilities for the extension of agricultural or farmer loans and have named the causes which I think have brought us to the present state of agricultural affairs, let us consider some of the remedies for the situation, for the agricultural problem is probably our greatest one today.

First, let me say that what we need is to provide ways and means for the farmer to get out of debt, and to do business on a cash basis as nearly as possible. How can we do it?

President Hoover, in his statement to the Federal Farm Board on its first meeting in Washington, said:

"Your fundamental purpose must be to determine the fact and to find the solution to a multitude of agricultural problems; among them to more

nearly adjust production to need; to create permanent business institutions for marketing, which, owned and controlled by the farmers, shall be so wisely devised and soundly founded and well managed that they, by effecting economies and giving such stability, will grow in strength over the years to come. Through these efforts we may establish for the farmer an equal opportunity in our economic system with other industry."

Since this was directed to a board whose purpose it was, and will be, to organize the cooperative marketing associations of the agricultural United States, let us first take up the work of the Farm Board as a possible remedy for our ills. Its main purposes are:

1. To minimize speculation
2. To prevent inefficient and wasteful methods of distribution
3. To encourage the organization of producers into effective associations or corporations under their own control, for greater unity of effort in marketing and financing farm marketing systems of producer-owned and producer-controlled cooperative associations
4. To aid in preventing and controlling surpluses in agricultural commodities, through orderly production and distribution.

From this statement we can see that the motives of the Farm Board are very high and worthy. I have great faith that the next few years will prove its efforts successful. The Farm Board, if it carries out its plans, will give to the farmer what the other industries have had all along—organization and proper management, plus conservative financial aid. I believe that the greatest weakness as shown in our agricultural picture of today is poor management and un-

organized effort to better conditions. Undoubtedly the men who will head these various cooperative associations have far more business judgment and skill than the mass of our farmers have demonstrated, and through their guidance I expect to see much accomplished by this new endeavor.

However, we must look on the Farm Board as an experiment until it has proved its actual worth and ability, so let us consider measures that we as bankers can take to relieve the farmer and try to pull him back out of debt.

First, we, as bankers, should not make a capital loan to a farmer unless we are certain that by receiving this capital loan the risk will be able to attain sufficient production to accumulate enough working capital to take care of that factor of his production.

Let us encourage the farmer to have more business organization on his farm, more thrift, and more diversification.

The governmental agencies should advise the farmer, at least sixty days in advance of planting time, what percentage of his average acreage it would be prudent to plant. Many farmers would follow this advice as coming from the Government. Through world surveys this information could be made to predict the demand for the various agricultural products with comparative accuracy, just as it is possible in other industries to estimate the demand for their products.

Costs of production must be lowered. It is difficult to say just how, but the adoption of modern farming machinery, the study of agricultural methods, as advocated by our governmental agencies, the patronage of

agricultural colleges and county agents, would be profitable. We must bear in mind always that for the betterment of our interests we should be able to produce at a good profit cotton that can be marketed at around eighteen cents; when our price goes above that mark we shall meet competition from Egypt and India and other countries in the international markets. Today we must recognize world markets more than ever before, as we are having to look to them more and more. The same holds true for other agricultural products: we must produce at a cost that will enable us to sell cheaper than other nations.

Diversification should be practised; we should tell our farmer customers that they must not place all of their crop in one commodity and that they must be as nearly as possible self-sustaining.

Many of you gentlemen are unit bankers—I dare say the majority of you are unit bankers—and you have been watching the inroads of branch, group, and chain banking into your field. Did you ever think of this? What if, for example, the whole of the South were to be dominated by two or three group or branch banks, and the situation were as it is today, with an urgent need for a reduction in cotton acreage? If this section's financial institutions were controlled by two or three banking groups, they could send out orders from their head office, instructing branch managers to curtail credit to the extent that they wanted cotton acreage reduced, and you would see a substantial reduction. But can we, as unit bankers, do that? Yes, we can; but whether we shall or not is another question. We have in some instances made progress along

these lines, but not as much as we might have made. The bankers of a section or of a state should organize in such efforts when need arises.

Last, we could remedy the farm credit situation by actually placing the farmer on the same basis of credit that we do a business house or an industrial plant: we could let the farmer submit a statement, compare his current ratios, see what his net worth is, and what his working capital is, analyze his statement, and grant credit on it, just as we would to any commercial borrower, but make no real estate loans. If we had done this before, I believe it would have saved many of our banks from failing during the past ten years.

In summary, I will say that the credit available to farmers through Federal Land banks, Intermediate Credit banks, Joint Stock Land banks, Federal Reserve banks, commercial banks, and credit merchants and individuals, is far more than is good for the agricultural borrower. This credit has been overexpanded. In addition to this handicap, the farmer has placed surpluses back into fixed assets in the form of land; he has shown poor knowledge of the costs of production; he has had to contend with the usual varying and uncertain weather conditions; he has speculated on the unearned increment of farm values; he has met inelasticity in the demand for farm products; his industry is individualistic in character, and it has slow turnover. To remedy this complex difficulty we have the new Farm Board, with its management and central organization, which are elements heretofore not existing to any great extent in the farming industry and which are necessary to success. We must stop making

capital loans. We must encourage thrift and diversification. Through governmental agencies we must advise as to the proper acreage to plant. The costs of production must be lowered. Organized force must be brought to bear, when necessary, to reduce acreage. And, finally, we must place the agricultural borrower on the same basis as we do our commercial account.

Discussion

EDWARD F. LEBRETON (Hibernia Bank & Trust Company, New Orleans): Mr. Wilson said he would not make a capital loan, which I take to mean that he would not make a mortgage loan. Is that the experience that the more progressive country bankers are adopting with their former customers?

MR. WILSON: It is generally the custom of country bankers, and has been for some time past, to take a mortgage from each farmer on his crops and the like, before credit is extended. The most progressive country banks in our district are trying as much as possible to get away from the old chattel mortgage. They are trying to get the farmer to manage his business so that in the fall he has a surplus left over, which will carry him a great way through his production period. This endeavor has met with quite a bit of success in our section. However, the mortgage is still prevalent.

MR. LEBRETON: Do you require the farmer customer, before you lend him money, to agree on a certain amount of diversification, and do you demand that he raise his own food and feed for his animals?

MR. WILSON: We always insist

that the farmer raise his own feed, but we do not dictate the extent to which he should diversify. We will refuse a loan to any farmer who does not have feed in his barn to care for his stock through the greatest part, at least, of the production period.

MR. LEBRETON: Mr. Chairman, I should like to have some of the others here say whether or not bankers are adopting a policy of requiring a certain amount of diversification before they will finance the farmer.

A. R. MERRITT (Bank of Sherrill, Pine Bluff, Arkansas): Yes, I think there has been quite a bit of progress, especially in the hilly sections. We are in the delta. I think they have made some progress along that line in Arkansas and perhaps in some of the surrounding states, but there is a great way to go yet.

ALFRED E. ROBERTS (Calcasieu National Bank, Lake Charles, Louisiana): May I be permitted not to ask a question, but to make a comment about an Intermediate Credit bank organization that happens to be operating in our section where it handles the financing of rice? It follows along the lines of Mr. Wilson's suggestion as regards the supervision of loans.

This organization takes from the farmers each year their statements, with the items segregated, as to land, crop assets, that is, the rice crop, rice on hand or seed on hand, cattle, equipment—all segregated—and a complete list of indebtedness set out. The principal thing which is different, I believe, from what is being done elsewhere, is that the farmer is required to make up a budget at the beginning of the year, divided as to overhead and crop expense, including under overhead such items as mort-

gage interest, taxes, new equipment, and similar things; on the crop expense, sacks, twine, feed, fertilizer, fuel, labor, repairs, living expense, insurance, anything going into the cost of making the crop. Three or four years ago when this method was started, the farmer had great difficulty. He thought it impossible for a man to figure out what his needs would be for each month during the year. However, after this length of time, it is possible now for the farmer, with the help of those who are operating this organization, to budget for each month his requirements for that particular month during the year; on the first of each month he has placed to his credit the amount that he needs, and he is permitted to check against that account if he is a responsible man. If he is a borderline risk, he is permitted only to draw a draft against that account. He is furnished with special check or draft forms, on which he must show the purpose for which the funds were expended.

Each month there is a report made up, showing the amount budgeted for the season and the amounts expended to date, so that it is possible to check whether or not all expenses are being taken care of. At the end of the year, a complete report is made up of the income from the principal crop or any secondary crops and a complete report of expenditures. That is done by the credit corporation and amounts to keeping the farmer's books for him.

In our section it is something entirely new and gives us information about which we had no idea, and gives the farmer accurate operating costs. The result has been that the per-acre cost of producing rice has been considerably reduced, and,

through the employment of inspectors who are practical farm men and make three or four inspections a year, good farm practice is encouraged through the whole section. The result has been that the average yield per acre is increased, and so the average cost per bag has been reduced below what was thought possible several years ago.

MR. MERRITT: Mr. Wilson, do you have any difficulty in getting financial statements from your farmer borrowers?

MR. WILSON: We take a statement which we reconcile from one year to the next. We have these inspectors. I omitted to say that they make an inspection of the land to find out the condition of repair of the buildings, that is, the homes and also the outbuildings on the farm, the drainage situation, and the irrigation facilities. In addition to that, a chattel mortgage is taken, and items included in the chattel mortgage are inspected, so that depreciation is taken into consideration by revaluation of the chattels each year; a report is made up from one year to the other of what the profit and loss for the period has been.

It is something entirely new for us. We not only have a statement, but statements that are consecutively checked with those of the years before.

MR. MERRITT: Do you make the statement, or does the farmer?

MR. ROBERTS: He makes the statement and we make the inspection.

CHESTER P. STEWART (Commerce Trust Company, Kansas City, Missouri): Mr. Wilson, will you explain briefly how cotton growing is ordinarily financed?

MR. WILSON: As I said a while ago, our practice for the past few years has been to try to get the farmer on his feet, where he can take care of his own financing. However, we still have, as Mr. Merritt said, quite a few in our section who cannot take care of their own production cost through the season. So, to guard our own safety in this case, we take, at the first time the farmer comes in to borrow money, a chattel mortgage which covers his crop and his stock and his farming implements. That is taken as a vow for the safety of the bank, and in many instances it would not be at all advisable to make a loan to a farmer without taking a chattel mortgage.

I would say that the average loan on a farm being operated, consisting of sixty acres, would be about \$400. A large portion of that probably would be in cotton, the next largest acreage in corn, and then in various other crops. I understand that in the wheat belts, hail insurance is taken out on the wheat crops. They also take a chattel mortgage, I understand, similar to our chattel mortgage taken on the cotton crops. However, in the cotton industry we do not take or require the grower to have insurance of this kind. Occasionally, we are visited by a hail storm, but that is not frequent, and the damage from hail and such weather conditions is very small.

THE CHAIRMAN: Have any of the men anything to say pertaining to farmer loans up in the wheat or live stock territory? Most of us have been down South.

DON H. WAGEMAN (American National Bank, Cheyenne, Wyoming): I believe, if I understood Mr. Wilson correctly a moment ago, one

statement was that the big problem now as you see it is to get the farmer out of debt. I think that is very commendable, but I just wonder if it goes far enough. My observation is that when the average farmer gets out of debt and gets a little surplus, the first thing he does is to buy something he does not need. That has been our experience in the live stock business. I believe Mr. Mitchell will bear me out in that. I was raised on a farm in Kansas, and I think it was the experience there. I wonder if you have any definite recommendations as to just how to keep him out of debt after you succeed in getting him out of debt.

WILLIAM THOELE (First National Bank, St. Paul): I was just wondering about the Joint Stock Land banks. I think there are some farmers in them. Wouldn't there be a little friendship connected with the loan the farmer wants to make? He may want \$1,000, but it may be too much.

THE CHAIRMAN: Our local Joint Stock Land bank here loans direct without the formation of any type of land company. It is my understanding that the intermediate company applies more definitely to the Intermediate Credit bank. The Joint Stock Land bank in Denver is being well operated under a very efficient manager, and I don't believe any farmer or stockholder could get a loan past Mr. McClintock or his examiners during their waking hours. Their trouble is something different. The Joint Stock Land banks in some sections have had so much difficulty with the loans they have made and the bonds they have put out that even a good Joint Stock Land bank cannot float its bonds. So, while we have

some loans which, we think here, are better practically than any loans that have been offered in the last ten or twelve years, bonds cannot be sold, and money cannot be obtained to loan. We feel badly that we haven't got money to put in on the loans at the present time.

MR. MERRITT: I should like to ask Mr. Wilson one more question. What per cent of its loans should a bank located in an agricultural community place in farmer risks?

MR. WILSON: I should say that the percentage of loans placed by a bank in an agricultural community on farmer risks would probably have to be a flexible percentage. I believe that it is not advisable for any bank in an agricultural community to place all of its loans on farmer risks. I would recommend that at least 25% of the loans of a country banker catering to agricultural borrowers be placed in either good bonds or commercial paper—something to form a substantial secondary reserve. Of course, this country bank must take charge of its commercial accounts, so probably not in excess of 50% of its total loans would go to the agricultural borrower.

GEORGE E. HELLEWELL, JR. (Ogden State Bank, Ogden, Utah): Does the Federal Farm Board have any definite power to use in curbing production of agricultural products?

THE CHAIRMAN: I am glad you brought up that question, because we are very much interested in hearing a little on what results you men have had in persuading your farmers to diversify their crops and lay off one that looks as though it very apparently is going to be in a state of overproduction in the coming year.

MR. WILSON: I might say that I

believe there is no definite provision whereby the Federal Farm Board is empowered to curb production. About two weeks ago I was talking with Mr. Henry, Treasurer of the American Cotton Growers Exchange, who was temporary chairman of this board upon its organization, immediately after the formation of the Federal Farm Board. Mr. Henry tells me that their plan is through an advertising campaign and propaganda sent out from their central office, to try to curb production when it is thought to be necessary. He cited instances over a period of the last thirty years where in about three or four cases, through an organized effort, cotton acreage was reduced anywhere from 10% to 14%.

That was rather a remarkable fact, to my mind, but he says that that is the case, and they do pin their hope on such action to reduce acreage when it is necessary:

HERBERT GEYER (Union Industrial Bank, Flint, Michigan): Inasmuch as Mr. Wilson looks with disfavor upon the farmer's idea of expansion by increasing his land holdings, what would you recommend to him for the investment of his surplus funds?

MR. WILSON: As I said in my paper, I would recommend that the farmer set up a secondary reserve of some liquid nature, just as a bank or business house should. He could buy good bonds in a year of plenty and readily liquidate those to get funds to take care of a lean year.

MR. MERRITT: Why in the world won't agricultural people do that? I have customers that operate anywhere from sixty to eight thousand acres to the man. There isn't a single one whom I can get to buy a bond.

Industrial Loans

By JOSEPH E. BIRNIE

ASSISTANT CASHIER OF THE MORRIS PLAN BANK OF VIRGINIA, RICHMOND, VIRGINIA

Address before the Denver Departmental Conference

Mr. Birnie quotes a former President of the American Bankers Association in explanation of industrial loans: "Suppose I had twelve mules and you wanted to rent them from me for a year, and I was willing to rent these twelve mules to you for a year for \$48.80. Well, I'd give you the twelve mules and you'd give me \$48.80, but each month you would have to give me back one mule!"

Mr. Birnie is in an excellent position to advise us on industrial loans, since the Morris Plan Bank of Virginia, of which he is assistant cashier, is the largest industrial bank in the South, and the third largest Morris Plan bank in the United States.

The Morris Plan system is based on three primary principles:

1. Character plus earning power is a proper basis for credit.
2. Loans made on this basis of credit must carry the privilege of repayment over a period long enough to match the earning power of the borrower.
3. Money so borrowed should always be for some constructive and useful purpose.

Mr. Birnie suggests the establishing of an industrial banking section of the American Institute of Banking for research in the subject as a whole.

FORMER Secretary of Commerce Redfield gave an excellent definition of industrial banking in the statement attributed to him that industrial banking is "banking organized down to the needs of the people." A former President of the American Bankers Association tells the story of a slightly different definition. Two friends of his, both contractors, were discussing the borrowing of \$1,000, and one suggested to the other that he go to a certain industrial bank, where he could borrow \$1,000 for a year at a cost of \$48.80. But the would-be borrower told his friend that he did not understand how industrial banks operated, and asked him to explain. His friend's explanation ran thus: "Sup-

pose I had twelve mules and you wanted to rent them from me for a year, and I was willing to rent these twelve mules to you for a year for \$48.80. Well, I'd give you the twelve mules and you'd give me \$48.80, but each month you would have to give me back one mule!"

A great deal has been written recently on this subject of industrial loans, in banker's magazines and elsewhere. Almost invariably the writer has attempted to formulate a set of rules by which he promises that an industrial department can be successfully operated, or he attempts to give other hidebound advice on various phases of the subject. In contrast to these courses of industrial banking in one easy lesson, I am merely going to

give you what few facts are in my possession, and not presume to tell you how, by a set of easy rules, you can conduct satisfactorily and profitably a phase of the banking business which, while twenty years old, is still in too formative a state for final conclusions to be drawn and served up to you as a simple formula for developing a tasty dish of profits.

HISTORY OF INDUSTRIAL BANKING

Industrial banking had its inception in the Scotch *Konto-Kurrent* or "cash-credit" system, which dates as far back as 1727 and which was based on the principle of revolving credit. By this is meant that the borrower, in being granted a loan, did not immediately withdraw all the proceeds of the loan but took out only what he needed as he needed it, and he was also privileged to redeposit sums as he was able. Thus, a revolving fund was created, and the borrower had to pay interest only on the amount actually used. Low interest rates were charged, and the loan was based on the personal security of the borrower with two indorsers. The advantages of the cash-credit system to Scotch industry have been incalculable, measured not only in money loaned to borrowers, but in the stimulus given to the thrift, frugality, honesty, and morality of the people; and this system, in its final analysis, is the prototype of industrial banking in America today.

More than a century later, the *Raiffeisen* (1849) and *Schulze-Delitzsch* (1850) people's banks were founded in Germany, and still later the *Luzatti* (1866) system was introduced in Italy. These people's banks were operated as joint stock

companies on the cooperative principle, and generally made loans only to their members.

PRIMARY PRINCIPLES OF THE MORRIS PLAN

To Arthur J. Morris, North Carolinian by birth and Virginian by adoption, belongs the credit for having established industrial banking in America. Mr. Morris adapted many of the principles of the Scotch cash-credit system and of the European people's banks to the needs existing in America for banking facilities for the individual, and he opened his *Fidelity Savings and Trust Company* at Norfolk, Virginia, in 1910, this bank being the forerunner of a national system of industrial banks. Prior to this time, there was no system of banking to which the average man, who did not have established commercial bank credit, could turn when in need of money in an emergency or for a constructive purpose. Mr. Morris's system was based on three primary principles:

1. Character, plus earning power, is a proper basis for credit.
2. Loans made on this basis of credit must carry the privilege of repayment over a period long enough to match the earning power of the borrower.
3. Money so borrowed should always be for some constructive and useful purpose.

The tremendous growth of industrial banking in the United States proves the soundness of these principles. Other systems of industrial banking sprang up, beginning in 1916, and by 1924 commercial banks had begun opening personal or industrial loan departments. It was not, however, until

the National City Bank of New York, then the largest bank in America, entered the field, in May 1928, that interest on the part of numerous banks throughout the country was created.

Commercial banks for years have been unwittingly making industrial or personal loans, but they have been making them on an unsatisfactory basis. Mr. H. N. Stronck, in his excellent book on bank administration, gives the example of a commercial bank which had 1,322 loans in force, of which number 575 were for less than \$300; or, as he shows further, 43.4% of the total number of loans made comprised only 3.2% of the dollars loaned. It is of course a well known fact that the income from such small loans is insufficient to meet the cost of money and the cost of handling, and many banks are either placing a service charge on small loans or are placing their small loans on an industrial loan basis. The American Bankers Association recommends one or the other of these two practices. As the straight commercial small loan, with the service charge provision, does not have the advantage of the self-liquidating feature which is a fundamental part of the industrial loan plan, and is therefore not so desirable, we shall discuss here only the latter plan. Commercial banks now operating personal loan departments generally make loans on this plan up to \$1,000, loans for larger amounts being handled, of course, on a straight commercial loan basis. Some commercial banks set \$300 as a maximum figure for personal loans, and others go as high as \$2,000; \$50 being as a rule a minimum. Industrial banks, however, generally make loans ranging from \$50 to \$5,000,

while in our own bank and some others, loans are made up to \$50,000, or to the limit of loan ability as related to the bank's capital account of \$1,000,000, \$2,000,000, or, as in the case of the Morris Plan Company of New York, \$5,000,000.

DIVERT SMALL LOANS INTO AN INDUSTRIAL DEPARTMENT

The task of diverting small loans into an industrial department is a problem which perhaps confronts some of you, and the conduct of such loans in such a department is the subject to which I shall confine the remainder of my remarks. Most of you are probably familiar with the details surrounding the inauguration of an industrial department, including the types or classes of customers served by such a department and the purposes for which industrial loans are made. Different plans are in use by different banks, but what is probably the most satisfactory and most universally used plan is that by which a borrower is made a loan for a definite length of time, say twelve months, as collateral to which he opens and assigns to the bank a savings account in which he deposits one-twelfth of the face amount of the loan each month. Two transactions are involved: one is the discounting of the note bearing the signatures of the maker and co-makers by the bank, and the other is the opening and assigning of a savings account by the borrower. A coupon pass book is issued, and the borrower deposits a stated amount, either weekly, semi-monthly, or monthly, the amount thus deposited being sufficient to retire his loan at maturity. The Morris Plan Bank of Virginia, feeling that any borrower who was re-

quired to accumulate funds at that bank should receive interest on his deposits equal to the interest he would receive in the savings department of any other bank, first conceived of and put into operation, in July 1922, the principle of the bank's paying interest on the required deposits against a loan. Interest thus earned on deposits is a distinct reduction in cost to the borrower, and this plan has been adopted by many commercial banks throughout the country.

RATIO OF PROFIT

However, do not be carried away by the idea that by putting your small loans on an industrial basis you will immediately begin to reap tremendous profits through a large increased income, because your ratio of profit will actually be little, if any, above that now received on your commercial or larger loans. A prospective borrower walks into your bank. You interview him regarding his circumstances, his needs, his prospects, his ability to repay. You then give him an application form and a note to be filled out and signed by himself and his co-makers, and then to be returned to the bank. After this is done and the application is returned to you in proper shape, it goes to your investigation department and a minimum of nine references are called, three on each signer of the note. The application is then sent to the liability index, where the maker's and co-makers' liability, if any, is placed on it. Your credit committee then reviews the application and passes on the credit. It may be approved outright, it may be rejected outright, or it may be sent back for additional co-makers, or for other changes, in which

case still further handling is necessary. When the loan is finally approved, the applicant comes back into the bank, is sent to the discount teller, signs the proper receipt, and receives the proceeds of his loan, either by check or in cash. And all within twenty-four hours, in the best organized banks! This seems to be a lot of minute, detailed work, but the bulk of the work is yet to come. A coupon pass book and ledger card have to be made up, and the proper entries on the bank's ledgers and other records must also be made. Then the borrower comes into the bank, either twelve or twenty-four or fifty times after that, to make his required deposits, and if he fails to come in according to the schedule agreed upon, and collection effort is necessary, still further handling, with consequent additional expense, is involved. Thus, you see, an industrial department must handle any given loan from twelve times to fifty times as often as a straight commercial bank loan would be handled, with consequent increased cost.

PROFITS COME FROM THE TURNOVER

The profits in this business come, not from the discount collected or the investigation fee, but from the turnover, and a substantial volume is therefore necessary in order to make any profit at all. But I will not attempt to tell you how much volume is necessary in order to make a profit. Frankly, I do not know. One writer in a national magazine says that an industrial department can be made to pay its way on a volume of \$100,000 of industrial loans, but this is doubtful. The smaller Morris Plan

banks show an average net income of 2.10% on approximately \$318,744 of volume; the larger Morris Plan banks show an average net income of 1.22% on approximately \$23,367,000 of volume. And these banks have been successfully specializing in industrial loans for twenty years. The cost of properly operating an industrial department is tremendous, and this fact must not be overlooked. You cannot have a true knowledge of the actual profit to be realized from such a department unless you first charge to that department its pro rata share of the proper expense items and overhead, such as salaries, advertising, rent, equipment, furniture and fixtures, cost of money, stationery and postage, administration, and many other items which will enter into its operation. Industrial banks have been criticized by commercial bankers for charging an investigation fee on their loans, which fee they claim is excessive, and these commercial banks undertake to prove their point by saying that they make industrial loans at 6%, without any credit investigation fee, and with no charge for insurance or delinquency. But do not fool yourselves, and do not be fooled by misleading advertising. For instance, one great eastern bank states that it makes loans for one year at 6%, no fee, pays 3% interest on deposits, and provides insurance on the loan, which insurance will retire the loan in full in the event of the death of the maker. But if you will study its operation closely you will find that the bank does not bear the cost of the insurance, but deducts it at the maturity of the loan from the interest due the borrower on his deposits! Another bank in the East with which we are familiar advertises loans at straight

6% discount and no fee. But it charges 6% for ten months only, not twelve, and it does not pay interest on the required deposits. The investigation fee covers actual credit investigation cost and is not a source of profit; it in no wise represents a part of the "rent" of money, and is used in establishing for the borrower the fact of his credit stability. It will be readily seen that considerable expense is involved in investigating an applicant and his two co-makers, all three of whom are probably unknown to any bank, financial institution, or credit organization. Their three names must be investigated as to employment, its length and compensation; and their credit records with at least two or more merchants must be checked. We do not feel that a credit investigation charge should be made on a collateralized loan, however, as no credit investigation cost is sustained on such loans. We see no reason to evade the issue; the credit investigation charge on small co-maker loans is frankly a cost that must be borne by the borrower, or the service cannot be profitably offered.

Our experience in this type of banking shows that in banks with an annual volume of less than \$500,000, the actual cost per dollar loaned is \$.065, and the actual cost per loan made is \$12.60. In the larger banks, whose annual volume runs in excess of \$10,000,000, the cost per dollar loaned is \$.073, and the cost per loan made, \$19.88. In a published article, the vice president of one national bank, which had a small-loan volume of approximately \$1,500,000, states that the cost per dollar loaned is \$.0325, and that the cost per loan is \$4.73. This seems to be an excellent example of one's

fooling one's self. It is obvious here that this bank is not properly charging all the legitimate costs of its small loan department to that department, and is therefore making the other departments bear an expense which should properly be carried by the department incurring it. Industrial banks, carrying no checking accounts and making no commercial loans but confining themselves to the amortization type of loan, must seek in the form of savings deposits funds they are to lend out. Hence, they usually not only pay a stiff rate of interest on savings but must pay a heavy acquisition cost. In setting up an industrial department, do not neglect to charge it with the cost of money, plus its acquisition cost, if you will be fair to yourselves and to the industrial banks in your community. No commercial bank can lend money at 6%, without any fee or other compensating charge, on loans of less than \$300 and properly charge all legitimate costs to the department, without undermining, by this price-cutting at a loss to themselves, the regular industrial banks in the community which are operating independently in, and having to charge rates necessary to pay for, their own quarters, their administration, their advertising and overhead expense, and a cost for money to lend equal to that of a savings bank.

NEW CONTACTS

Again, it has been claimed by some that the operation of an industrial department by a commercial bank is justified by indirect results obtained in the form of new contacts made for the bank through this department. But let me quote to you from a commercial banker who has

operated probably as long as any one else, personal loans in a commercial bank:

"You are particularly interested in getting savings accounts, and while it is a fine theory that when a borrower gets through paying a loan he might continue paying the same amount in a savings account, I am sorry to say that it does not work out that way. You will oftener find that the borrower will renew his loan before it is fully paid out or soon after it is paid. They seem to get the habit. After a small loan department has been in operation about two years, we find that over 60% of the loans made are to previous borrowers, and perhaps 75% are to previous borrowers and co-makers, so you will see that your best advertisement is your customers. Of course, I don't want to be understood as saying that you will not get some savings accounts, but not enough to warrant the operation of a department of this kind without a profit."

That, perhaps, is as definite a result as you can find from your point of view. But here is another proof that facts are elusive, for this same banker states:

"While a department of this kind brings quite a number of contacts to a bank, and some of them valuable and lasting, still, we feel that it ought to be operated at a profit and not alone for publicity or altruistic motives."

PROBLEM OF DELINQUENCIES AND LOSSES

One of the biggest problems facing the successful operation of any industrial loan department is the problem of delinquencies and losses. The problem of delinquencies is big because there are twelve or twenty-four or fifty so-called due dates, the number being dependent upon the sched-

ule of deposits, compared to the single maturity or due date of a straight commercial loan. In the Morris Plan system an account is considered delinquent on which there is a deposit as much as twenty-eight days overdue, and what have come to be generally accepted maximum percentages for delinquency are 2% of amount and 6% of number. In other words, if more than 2% of volume or more than 6% of number of loans outstanding are as much as twenty-eight days past due, the normal for healthy condition has been exceeded. A well thought out plan of past due notices and form letters, coupled with telephone calls, personal letters, and even personal calls by outside representatives, is very essential. Also, an adequate system of delinquency charges not only spurs the chronically delinquent borrower to come in on time but also helps to pay the expense of handling the delinquent accounts. The old order of Morris Plan banks, and even the largest commercial bank in the country operating an industrial loan department, have a practice of charging the borrower five cents for each dollar on which payment is delinquent in his prearranged schedule of deposits. Our own bank has adopted the more equitable method of charging the borrower simply with the loss of interest on the amount delinquent and with the actual expense incurred in the collection of the account.

A constructive attitude of cooperation with the borrower who is not deliberately delinquent, but who needs the assistance of a reminder or who is honestly in need of help, is in our opinion the proper attitude to be adopted by a collection department at the outset. It is only when it becomes

apparent that the borrower is intentionally (or, to one who has had experience, maliciously) delinquent that the collection department then must take a firm attitude and proceed vigorously to protect the loan against loss. An excellent opportunity presents itself in the handling of delinquencies to cooperate with and assist those who are unfortunate enough to be in need because of circumstances beyond their control. Accidents, unemployment, death, change of jobs, and numerous other distressful occurrences make available to the bank this opportunity really to help its customers. It is at this period of a customer's affairs that a bank can almost literally "make or break" him. Too many small-loan managers are prone to adopt "hard-boiled" collection methods, whereas an intelligently directed sympathetic attempt to assist constructively the borrower who is in temporary financial straits brings increased returns not only in the form of better accounts but in the happy realization of a good deed done. Also, it is well to remember in the handling of delinquencies that the person or persons who have charge of your past due accounts are the only ones in your organization with whom the co-makers on your loans come in contact, and that your co-makers, who represent a vast, undeveloped, potential field of new business for your bank, are apt to judge your institution by these individuals and the treatment received at their hands. I do not mean, however, that firmness should be displaced by any weakness that might arise through fear of losing good will. The problem of delinquencies is by no means an insurmountable barrier between you and the successful operation of an indus-

trial department, but it is a problem which might well cause more trouble, friction, worry, and expense than any other one phase of the business, unless it is at all times given constructive, aggressive, intelligent attention.

Another phase of industrial banking that must be considered is that of insurance coverage. This coverage is usually made available by industrial banks in the form of term insurance, by which the borrower may protect his co-makers or his estate from the necessity of paying the loan in case of his death or total and permanent disability. This insurance, the advantages of which are obvious, can generally be furnished borrowers of commercial banks through the larger insurance companies, or otherwise, at a small premium.

LOSS EXPERIENCE OF THE MORRIS PLAN SYSTEM

Assuming that the direction and operation of your industrial department is in capable and experienced hands, your losses should not be excessive. The loss experience of the six largest banks in the Morris Plan system, which banks' total loans made range from \$35,000,000 to \$270,000,000, averages less than $\frac{1}{4}$ of 1%. But remember that these banks have been specializing in this type of loan over a period of years. Losses come primarily from bad credits made at the outset. Frequently, in the desire for volume, the overoptimistic credit officer will completely ignore fundamental credit principles and will approve loans which ought never to have been made. But the proper man in charge of delinquencies and losses should be able virtually to control the credit policies relating to industrial

loans, because it is through him that the efficiency in credit judgment of every loaning officer is reflected. He has at first hand the opportunity to see the results of every credit passed by every credit officer, and by intelligently and intensively studying and analyzing the delinquent and loss accounts of his bank over a period of time, he should be able to arrive at certain credit principles for any given bank in a given locality. On the other hand, we would not attempt, as others have done, to set down a rigid set of rules for making industrial loans. Conditions vary in different localities. Circumstances alter cases. For instance, one casual writer on the subject sets down a definite rule that you cannot lend to a man in excess of 20% of his annual income. But again, circumstances alter cases. Our own experience has shown that under certain conditions we can lend a man as high as 50% of his income and still be safe. Every new application for a loan presents a new problem, and must be handled accordingly. This same writer, in another article, cites the rule that, in discounting loans, drafts payable only to the borrower's creditors, and not to the borrower, should be issued; and he goes on to say that, while the advantages of this rule need hardly be mentioned to a group of bankers, still, many small loan departments fall into the error of paying in cash. My only answer to that is that in the past eight years we have loaned to our customers something over \$35,000,000, more than 95% of which was paid out in cash!

Our bank was organized and began business only eight years ago, but since that time we have grown from nothing to be the largest industrial

bank in the South, the eighth largest bank of any kind in the State of Virginia, and the third largest Morris Plan bank in the entire United States, our resources now exceeding \$11,000,000. But with those eight years of our own experience, plus the benefit of the additional twenty years of experience of the Morris Plan system, and with that record of growth behind us, we would not attempt to formulate for you a series of rules by which you might correctly operate an industrial department. We do not feel that we know enough about the subject yet to do this. We cannot tell you whether you can or cannot make loans safely to any given class of people. We cannot tell you whether a barber is a better risk than a huckster, or whether an unmarried working girl is a better risk than a married one. We cannot tell you accurately what are the principal causes of delinquency or of losses. We cannot tell you definitely how to determine in advance whether any given loan is apt to be good, slow, or bad. We cannot tell you these things because we do not know. But we are trying to find out. We are expending a great deal of time and effort in research work, and we are looking for facts, not superficialities. We are carefully analyzing our slow loans, our doubtful loans, our charged-off loans, our rejected loans, the loans we have to sue on. We are taking them apart to try to find out what keeps them from ticking! Some one has said that we have no right morally to decide as a matter of opinion that which can be determined as a matter of fact. And in this research, this striving for facts, we invite the co-operation of commercial banks, and in turn offer them our every facility.

The movement should be cooperative. You have often heard it said in the recent past that the great need existing in banking today is for research. A few years ago, just prior to the opening of our bank in Richmond, our president and senior vice president were out riding one day and stopped in front of a billboard on which appeared the advertisement of a commercial bank. The advertisement was worded: "Banking, centuries old, today stands complete." It will interest you to know that that bank no longer exists but has been absorbed by another institution which has added an industrial loan department!

A great many people have thought that industrial banking was so simple that anybody could operate an industrial bank or industrial department of a bank. It is a truism that one gets out of a venture what one puts into it, and if you put simple management in charge you must not expect anything to come out of it that is not simple, too.

NECESSITY FOR SPECIALIZATION IN INDUSTRIAL BANKING

In conclusion, let me impress upon you the necessity for realizing that industrial banking is indeed a business which requires specialization, and that any of you commercial bankers who are contemplating entering the field should see to it that your personnel as well as your physical set-up is prepared to handle an operation which from beginning to end is certainly different from commercial banking and in some instances requires policies diametrically opposed to those followed by commercial bankers. I appeal to you for openmindedness and a desire for facts rather than opinions. A

magnificent opportunity awaits you for the intelligent studying of the industrial loan problem right here within the American Institute of Banking. An industrial banking section of the Institute could be formed, similar perhaps, in many respects, to the industrial banking sections of many state bankers' associations. This industrial banking section could conduct investigations and research, and ultimately could foster regular educational classes, and I urge you to give the establishing of an industrial banking section of the American Institute of Banking your earnest thought and consideration at this convention.

Discussion

THE CHAIRMAN: Gentlemen, I believe you will agree with me that if all industrial banks had the standing and integrity and ability of the Morris Plan banks, we bankers in the commercial banks would not be giving very serious attention to the question that has been discussed. However, that is not the case. I am not sure that Mr. Birnie, by his remarks, has encouraged any of you to start an industrial loan department. However, our investigation in the bank in which I am a director was rather favorable to the entire question, of course, after volume had been developed.

We have received certain comments that are typical of what Mr. Birnie has told you. We found that customers did not maintain savings accounts afterwards in these banks we wrote to, but rather formed the borrowing habit and kept that much ahead of the hounds all the time. When they got one loan paid off, they started a new one. They seemed to like the idea of having something to

pay on. It encouraged them to go and buy a radio or a car or some other thing on the basis of the industrial loan, rather than buying through acceptance.

We did find, from some of the comments, that the amount of business developed through the co-signers and the original maker of the note in a banking way where they found friendly service and attention, was mentioned in a number of the letters we received. We also have found in the short time our bank has been doing this type of loaning, that a number of people who come in with the idea of making an industrial loan actually give you good, sound collateral on the basis of a loan they could make at another bank, but take the industrial loan rates, and would prefer to have that because they like the deposit and savings account and like the idea of paying off a little at a time.

HENRY B. WITTPEN (Bank of Italy, Sacramento, California): Mr. Birnie, we have this system in our larger branches. I should like to ask from what source you receive your interviews in regard to co-makers? Do you have the cooperation of a retail credit association?

MR. BIRNIE: We operate primarily on the principle of the credit references which are given by a borrower. He will usually list a couple of retail merchants from whom he buys on credit, and we have a direct telephone connection with those merchants, who are very glad to give us any information desired. We also use retail merchants' information from Dun's and Bradstreet's and other credit organizations.

MR. WITTPEN: At what rate do you charge the principal amount, for

instance, and the percentage for the fee? Do you have a set amount?

MR. BIRNIE: Yes, our fee is charged only on co-maker loans in amounts of less than \$1,000. As I stated before, we make no investigation charge on a collateral loan, because there is nothing to investigate. There are no co-makers on a collateral loan.

On loans of more than \$1,000, we find that it is not necessary to charge any investigation fee. On co-maker loans under \$1,000 we charge \$1 for each \$50 borrowed, up to \$250, and then \$1 for each \$250 after that. It is scaled downward in accordance with the size of the loan.

HOLDEN NAFF (Industrial Savings Bank, Birmingham, Alabama): I might say, after your kind remarks about the Morris Plan, that we own the Morris Plan franchise. The problem you just mentioned in regard to

taxation is something we are working on in Alabama. Certain institutions got through some legislation in Alabama exempting them from taxation as industrial bankers. Of course, that is something that has never been exactly defined and we are working on that problem ourselves.

Mr. Birnie mentioned something about the loss ratio. I believe he said he considered $\frac{1}{4}$ of 1% a conservative figure for losses. In our own institution, operating over a period of fourteen years, we have actually lost between \$2,500 and \$3,000. Our volume has been from \$15,000,000 to \$18,000,000, so our loss ratio has been almost unbelievably small.

MR. BIRNIE: That is an excellent ratio, but I was taking the average for a certain group of banks throughout the country. Of course, there are individual cases where it is either higher or lower.

The Credit Department and Credit Bureaus

By ROBERT D. KERR

ASSISTANT MANAGER OF THE CREDIT DEPARTMENT, FIRST NATIONAL BANK
IN ST. LOUIS, ST. LOUIS, MISSOURI

Address before the Denver Departmental Conference

Mr. Kerr discusses the significance of the credit department and of credit bureaus. The value of the credit department of the individual bank has never been seriously questioned, but the importance of the interbank credit department, the credit bureau, has still to be recognized.

While the credit bureau apparently does its most effective work among banks in the smaller communities, and is of particular value among agricultural institutions, yet instances can be cited where certain large banks in the larger centers would have saved substantial sums, had an efficient credit bureau been in operation.

Changing times have made such a bureau a paramount necessity. It need not always be comprehensive; often a simple organization will suffice. But in one form or another, there must be such cooperation among banking institutions, because the permanence and success of each institution depends not only upon the solvency and prosperity of its own customers, but also, to a very large degree, upon the strength and solvency of its competitors, and even of its competitors' patrons.

ANY consideration of the subject assigned to me, must, for the purposes of this conference, be from the standpoint of fundamental merits and general banking policy, rather than from that of specific departmental problems or the details and mechanics of operation, either in the case of the bank credit department, or of credit bureaus in those cities and communities which have that plan in operation.

This subject, as well as those to follow this morning, is being treated under the general topical heading of Profit-Producing Policies, a viewpoint reactionary to those minds which are inclined to rate the credit department as a more or less necessary, but ex-

pensive investigation and service bureau, and, in no sense, certainly, "profit-producing." Indeed in some mercantile circles, but not in any banks that I have direct knowledge of, the heads of the firm have seriously questioned the value of the credit department in any case, and have been very emphatically of the opinion that their company, by a general policy of accepting any and all business which their sales force presents, unrestrained by the cautious, conservative hand of the credit executive, would tend not only to a substantially increased volume, but, through the saving of a credit manager's salary and other departmental charges, actually bring their loss ratio

below the figure of present experience. This is no idle statement. The credit man of a St. Louis shoe house recently stated this to be the earnest conviction of his superiors. To be sure, they had spent the major part of their careers in the sales end of the business, and, after all, it is quite reasonable for each of us to consider his particular job as being of the very essence of importance to his institution. If you do not believe this, just listen to a few of the speakers before these conferences. However, we would not have it otherwise; the assumption and acknowledgment of responsibilities is the very mainstay of American unit banking, and its loss is what students of the subject fear as a possible consequence of chain or group banking organizations. But I am digressing; to get back, while I am confident that we would have some difficulty in substantiating to some people at least, our claim for the credit department as a "profit-producing" banking function, I am reasonably sure of my ground before this gathering. The modern bank credit department, operating as a safeguard to a bank's most important and most profitable function, namely, the safe lending of its depositors' funds, preventing losses in present and future loans, rendering a degree of service in retaining the business now on the bank's books, and laying the foundation for the acquiring of new business, can justify before the modern banker its proper inclusion in the classification "profit-producing."

It is trite, but none the less true, that the greater the degree of service rendered, the greater is the ability to serve. As in every other human relationship, the channel through which

one gives, is the channel through which he receives; and while often a considerable burden is imposed upon the bank's credit department, in countless investigations for patrons, for correspondents, and even for casual inquirers, on the widest variety of subjects, from companies long since out of existence, to concerns of possible future projection, and prompted by any occasion, from the seeking of investment service to using the bank's influence in securing a business contract, such endeavors all tend to develop files on the widest variety of subjects, developing innumerable sources of information, contacts, and leads, which so often prove of immeasurable value to the bank and are so often taken as a matter of course.

COOPERATION BETWEEN BANKS

So much for the case of the individual bank. But banks, in different cities as well as in the same community, have long ago discovered that their very existence depends on a frank and open attitude of mutual cooperation, cooperation not alone in working out the entangled affairs of a common creditor, whose position has become precarious, but in reasoning and taking counsel together to prevent a situation from reaching that stage. The majority of banks today confide in each other without hesitancy, exchange views, and answer any question for which there appears a plausible justification, concerning any of their accounts. The clearing house was one of the earliest developments of this spirit of cooperation, and, within our own time, the formation of the Robert Morris Associates and the promotion of the

credit bureau plan are outstanding examples.

While the exchange of information and experiences and the frank expression of opinion have grown out of this relationship, much more has actually been accomplished by the development of sound credit policies, the raising of the standard of ethics, the breaking down of narrow competitive rivalry and opposition, and the dispelling of fear and distrust, which have kept humanity, institutions, and nations in bondage through the ages. The widest possible co-operation exists in the community from which I come. I recall letters by our bank of the frankest possible nature, expressing decided reservations about a large wholesale dry goods house which later fell with an awful crash; even in the case of business solicitation, our banks, when told frankly of the occasion for the inquiry, get out their folders and balance cards and lay all the facts before the inquiring bank. They probably strengthen their tie later, if the account is worth saving, by taking the finance officer of the company out for a round of golf and letting him win; but it has been our experience, that if the account is questionable or plainly "n. g.," the bank of deposit will invariably give the facts, even though to report it otherwise might free them from a very unsatisfactory situation.

THE CREDIT BUREAU

The credit bureau idea is a more recent development of this spirit of cooperation. While it apparently does its most effective work among banks in the smaller communities, and is, as it is said, of particular value

among agricultural institutions, yet instances can be cited where certain large banks in the larger centers would have saved substantial sums, had an efficient credit bureau been in operation. However, from the information which I have been able to develop, only a very few city clearing houses have attempted any credit bureau operations. Of course they can be said to function somewhat along this line through a competent and alert examiner, whose periodic rounds might unearth duplicate borrowings of any consequence. The drawbacks to that are, of course, the lack of a definite system and the fact that examinations are often at intervals of some length.

CREDIT BUREAU MAY BE COMPREHENSIVE OR SIMPLE

As explained by the American Bankers Association in educational tracts on the subject, the credit bureau may be very comprehensive or extremely simple. It may operate as a central credit department for its members, who would supply financial statements and other data on its customers; it may be a clearing house for loans, for collateral, and for investment securities carried by the banks of the community. It may and more often does function merely as a fact-gathering organization to which all loans are reported by the member banks, giving only name and address of borrower or indorser, without divulging amounts, basis, or other particulars. If the secretary-manager whom the banks appoint to handle the details, discovers a duplicate borrower or one who is favoring seven or eight banks at one and the

same time with his loans or his guarantee, the manager immediately notifies each institution concerned, giving only the bare facts disclosed and naming the other banks only by a code letter. If the respective banks view the situation as serious enough, they can get together with the manager for a little heart to heart discussion as to particulars of the case and the best method to adopt.

As the various state bankers' associations point out, changing times have made such an activity of paramount necessity today. Hard roads and rapid transportation not only have extended the confines of mercantile trade, but have made it possible for the farmer or merchant to carry additional bank accounts in neighboring towns, the banks there of course inviting and welcoming such business; the step is relatively short from carrying the account to borrowing money. It was particularly so about a year ago, when banks almost thrust the accommodation on the patron. The same situation led to the formation of the Interchange Bureau of the National Association of Credit Men. Duplicate purchases made in the trade found two or more wholesalers or jobbers holding accounts of defunct companies, when each thought that it alone was the only house selling the name. Later, retailers cooperated in reporting on individual names to a central bureau, so that today a merchant in Los Angeles, for example, can get the past paying record of a new resident recently living in Portland, Maine, almost as soon as he arrives. But banks have been slow to adopt the idea, partly for the reasons we have considered, fears and suspicions, and partly because of an attitude that re-

gardless of what their neighbor may do, or what may be the condition of the note-case of the bank in the adjoining town, they know their loans and the record of their patrons, and they prefer to remain aloof. Credit losses have, however, been increasing year by year. It seems to take much misfortune and trouble to bring banks to a realization of the benefits of a cooperative union through such a plan. One of the strong supporters of the credit bureau idea, Lyon Carr, President of the Illinois Bankers Association, cites the case of the reluctance of the banks in Bloomington, Illinois, to adopt the plan, until, one fine day, five banks there awoke to a loss of \$50,000 apiece by the failure of a customer, who, each thought, was indebted only to itself. Records show that in the great majority of cases of failure, the bankrupt has been owing more than one bank, and the credit bureau appears to be the only means of combating successfully the evil of duplicate borrowing.

INTERDEPENDENCE OF BANKS

Both the credit department and regional or federation credit bureaus are dependent upon the very highest degree of confidence and cooperation. After all, it is the common sense procedure. The permanency and success of each institution depends not only upon the solvency and prosperity of its own customers, but also, to a very large degree, upon the strength and solvency of its competitors and of its competitors' patrons. The word cooperation does not mean a concerted, altruistic labor in behalf of the other fellow; it has a more selfish end, a devotion to the other's affairs that a situation may be created tend-

ing in the final analysis toward our own best interests and welfare. Just why such a plan should be difficult to sell to the bankers of the country is hard to explain.

The Chicago Journal of Commerce about a month ago, in editorial comment, stated that the credit bureau idea should be carried further, to the full function of regional clearing houses, and took the banking business generally to task for its failure immediately to cooperate in establishing such agencies for the restoration of a waning public confidence and the salvation of the unit system.

It is in large measure a matter of education, education both in confidence and in cooperation, and it appears to me that the Institute, which has done so much to enlighten and inform men and women in the banking profession, would be a splendid agency to propagate so constructive a plan.

Discussion

EDWARD MCGOWAN (City Trust and Savings Bank, Youngstown, Ohio): About four years ago Youngstown experienced a number of bankruptcies. Bankers became rather exercised over the situation and later organized a group to meet with the Credit Adjustment Bureau. They met every two weeks, and that plan of meeting has been continued ever since, with a consequent decrease in bankruptcies. We find that the interchange of information has been very helpful to our credit department.

Any information we desire relative to any account is forthcoming from the other banks. If they are not able to give it at the time of the meeting, they can report back to their

banks. They call us on the telephone and give us a complete record of the accounts.

FRANK WALKER (First National Bank, Cameron, West Virginia): A little over a year ago, our county organized a clearing house association. There are three banking centers or towns in the county, and one has a population of 2,500; another, 17,000; and the third, approximately 2,000. The clearing house organization furnishes blanks, and we can write the other banks to get a line on the customer to whom we want to refer. Thus far it has been very satisfactory. They have been very quick to respond and give their line on the customers that we may think have borrowed money at various banks.

MR. KERR: May I ask if that is only on occasions of inquiry? You don't clear the names of borrowers in your community, do you? Would it be possible under that plan to obtain the names of duplicate borrowings? I gather it would not.

MR. WALKER: We simply ask for a line on the customer we refer to. That is the length to which we go in the inquiry.

MR. KERR: The credit bureau plan, of course, is a plan of having banks in a given community send to one central bureau the names of all their borrowers. Then the secretary-manager assembles all that information, finds that John Jones is borrowing in three or four banks in that community, and notifies each of those institutions to that effect. This is the only means by which such information would be obtainable.

MR. WALKER: We simply write to the bank we think the customer is borrowing from. We don't write to

the clearing house secretary, but simply to the bank.

THE CHAIRMAN: It would be interesting to note in how many towns represented here this morning they do have these credit bureaus or other sources of getting credit information. Let's see a show of hands.

. . . A majority of the members raised their hands . . .

MR. LE BRETON: How many have actually a credit bureau where names of borrowers may be reported?

MR. KERR: May we put that just this way: How many here have credit bureaus in their communities through the city clearing houses or through the county federations or other organizations—the credit bureau plan, as we have tried to sketch it here? How many have such a plan where they report duplicate borrowers?

. . . A majority of the members raised their hands . . .

MR. KERR: That is a considerable number.

CLARK G. MITCHELL (The Denver National Bank, Denver): Mr. Chairman, last night I attended a small dinner for credit men at which Alexander Wall, Executive Secretary of the Robert Morris Associates, was present; there were also a Cleveland banker and a number of bankers from large cities. They mentioned one matter which, I think, is of primary importance and keys right in with this. It is the springing up of a number of so-called credit associations pertaining to various building trades. A lot of people haven't much to do at the present time, so they organize a little retail or wholesale credit association pertaining to the structural steel business or the brick and mortar business or the cement business; to give

you an idea to what extent this thing has grown, in Cleveland it was mentioned that there are ninety-two of these little organizations that obtain their own credit information for their particular industry or trade.

You can see that this type of credit information would be of practically no use to anybody, not even to the fellows who are in it. It would be imperfectly gathered. There would not be enough money available to justify the creation of a real credit association. There would be no centralized source of information, and the net result would be they would have very little information of any kind.

The result in Cleveland, and perhaps Mr. Huelsman will bear me out, is that the contractors there had a whole lot of what they called receivables on their books that were of practically no value, simply because their credit information in taking these receivables was very limited and inaccurate—practically valueless.

The reason I am making these few remarks is to express the hope that you will keep your eyes open in your own communities and will try to keep the credit bureau, not specifically the bank credit bureau, but the retail credit association, in a centralized position, where it will gather accurate information and be available to everybody who is interested in credit, and not allow the information to get disseminated all over the community and be of no use to anybody.

MR. KERR: In that connection, the Better Business Bureau in St. Louis recently sent out a bulletin on that same situation, asking the cooperation of business men generally in not subscribing to such an idea.

ALBERT C. BURCHETT (Bank of Commerce & Trust Company,

Memphis, Tennessee): I believe I should be remiss in my duty if I did not take this opportunity to help along an organization in which I happen to be a director. That is the National Association of Credit Men. The matter that Mr. Mitchell has presented to you here is one that has given us a good deal of concern. The National Association of Credit Men is now "fishing" to organize various industries in groups, and this will be done under the direction of the National Association of Credit Men. The credit information that will be brought together for a particular industry—say brick, lime, cement—will go through the credit office, that is, the wholesale credit men. Mr. Mitchell mentioned the retail credit men, but we have mainly the wholesale. As Mr. Kerr told you, if a man moves from Denver to Tampa, Florida, they can get that information right out of the adjustment bureau office in that particular industry.

We have already brought together quite a number of manufacturers. For instance, we have the furniture people pretty nearly lined up. They are working now on the plumbing industry, and we are doing that to offset, as Mr. Mitchell says, these fellows going around the country and selling

these various organizations. When they get the dues and the set-up, they don't have enough money coming in to take care of the overhead.

WILLIAM R. CHAPMAN (Midland National Bank & Trust Company, Minneapolis): What is the general practice of retail credit bureaus in charging banks for information received?

MR. KERR: I can speak from our own experience in St. Louis. The retail association has as its members nearly all the banks in St. Louis which subscribe to its services; but, in addition, for a report on an individual (and it is largely ledger experience of the retailers of the community), the Association of Retail Credit Men (that is not the National Association of Credit Men) charges seventy-five cents for a report. It is a very complete report. It is often effective when you want an immediate expression as to how the individual is handling his accounts at the various retail establishments.

MR. CHAPMAN: Is it verbal or written?

MR. KERR: Sometimes it is given over the telephone. The contract we have, I believe, provides for telephone requests at thirty-five cents, and for a written report at seventy-five cents.

A Simplified Cost System for Banks

By R. C. HUELSMAN

COMPTROLLER OF THE MIDLAND BANK, CLEVELAND, OHIO

Address before the Denver Departmental Conference

Mr. Huelsman explains his system of cost accounting by means of six very useful charts:

1. List of the departments of the bank
2. Classification of expense accounts
3. Expense ledger
4. Departmental expense ledger
5. Monthly record of items handled
6. Distribution of general overhead and service departments.

Through these charts and his explanations of their use, Mr. Huelsman shows that cost accounting need not be an intricate and complicated procedure, and that it need not involve very much additional clerical effort or great expense.

"A properly operated cost system," Mr. Huelsman says, "will pay for itself many times over by giving you a better control and by bringing to your attention inefficiencies, leaks, and extravagant expenditures in many parts of your organization."

THERE is a growing tendency among progressive banks today toward a study of production and production costs with the same object in mind that manufacturing establishments have had for years past. However, I think that a large number of banks are still without a cost system, and this does not apply only to the smaller country banks: I have found that even some of the larger city banks are still without a dependable method of determining their costs.

CAUSES OF LACK OF INTEREST IN COST ACCOUNTING

This apparent lack of interest in cost accounting by banks is, I believe, due mainly to three factors: first, the many important advantages have not occurred to them or been brought to

their attention; second, they have a fear that cost accounting is an intricate and complicated procedure, and, consequently, they avoid the subject; third, it necessitates the additional clerical effort and expense of operating the system.

Is it not a strange fact that while banks have been urging their customers for years to know their costs, banks themselves have been neglectful about studying their own costs, and have always more or less ignored the operating efficiency of their institutions? Perhaps this has been due somewhat to the nature of the beast. The banking business is a rather stable business and normally does not have the ups and downs in its earnings that many industrial businesses are subject to. A bank is usually headed by an executive who devotes most of his time either to the loan function or to

the development of new business, and the internal administration is delegated to some other officer, usually the cashier. The cashier, being the principal operating officer of the bank, has constant contact with customers throughout the day and does not find the time, even if he may have the inclination, to study costs and operating problems. He, too, is very much absorbed in loan administration and new business, because he is interested in following in the footsteps of his superior officer. As a result of these conditions, I think you will find that in many instances where banks are employing cost systems, these installations have not been initiated or recommended by the chief executive officer, but rather have been due to some aggressive young fellow down the line who recognized the possibilities of a cost system, and was able to sell the plan to his institution; I believe that many a promotion in recent years has been earned in this way. When properly installed, a cost system can be the means of significant economies in operation.

The second and third factors can be answered as one. Bank accounting as a whole is rather simple in comparison with many forms of industrial, public utility, and railroad accounting. This being the case, it naturally follows that bank cost accounting should also be comparatively simple. Your cost system therefore need not be vastly complicated and it need not entail a tremendous amount of detail; in fact, it should be as simple as possible. If you construct and operate it along simple lines, it will not be expensive to operate. A properly operated cost system will pay for itself many times over by giving you a better control

and by bringing to your attention inefficiencies, leaks, and extravagant expenditures in many parts of your organization.

ADVANTAGES OF A COST SYSTEM

The first question which naturally arises when the matter of a cost system comes up is "Why should we have a cost system and what will it accomplish?" One of the principal benefits to be derived from a cost system is that it will show you what is going on inside your bank. It breaks up your expenditures into relative groups which can be easily analyzed and so affords a control over expenditures. If you have no cost system in your bank, you have a few surprises coming after you get one in operation and get your figures assembled. How do you know whether your transit, clearance, and bookkeeping departments are efficiently operated, or whether they are over-manned? How do you know whether fees charged for various services are adequate to give you a profit, if you do not know what the cost of operating those particular functions is? With lower interest rates this year and increased competition, the matter of knowing and reducing your costs is daily becoming more important. Cost accounting will give you a basis on which to start a departmental budget system, and it will enable you to ascertain the cost of your deposit accounts; it will put you in the position where you can intelligently discuss with your customers the cost of carrying their accounts, the reasons why their accounts are unprofitable, and the reasons why they should increase their balances. Right-minded customers do not expect their bank to lose money on their accounts,

and, when properly approached with convincing facts and figures, they are usually willing to build up their balances or are agreeable to a compensating service charge.

When it comes to the details of setting up your cost finding procedure, you will find that you can make it as simple or as complicated as you choose. Some banks have installed very comprehensive systems, from which they prepare lengthy and cumbersome reports. Sometimes the information presented on these reports is so lengthy and so poorly presented that it is difficult to find any one to take an interest in it, and of course unless the statistics produced by your cost system are used as a basis for some action or control, the cost of producing the statistics has been wasted. Other banks do not get into the subject deeply enough to get reliable figures, and consequently the results they arrive at may be wrong or misleading. For the majority of banks a middle course appears to be the most sensible procedure. Personally, I like to keep all methods as simple as possible, and I am going to try to outline a method we use in our bank, which I think is rather simple in operation but which is capable of producing excellent results. Of course, it takes a bit of thinking and planning to get the system started, but once you have it in operation you will find that it functions almost automatically. The essential point is to have your method established on a sound basis, because wrong or misleading cost figures are usually worse than no figures. If your method is sound, it will be possible to expand it later, should you find it desirable to have a more elaborate or comprehensive system.

LIST OF THE DEPARTMENTS

The first thing to be accomplished in getting your system started is to make a list of the departments of your bank (Exhibit "A"). All of the activities of the bank must be assigned to one of these departments. To each of these departments should be assigned a number. A letter of the alphabet could be used for this purpose, but I think you will find the number scheme more flexible. General overhead expenses should be segregated and should also be assigned a number. This will complete your departmental set-up.

CLASSIFICATION OF EXPENSE ACCOUNTS

The next thing to do is to determine your classification of expense accounts, such as salaries, rent, and postage (Exhibit "B"). While all banks have some form of such classification, you will find this a good opportunity to give your classification scheme an overhauling. I think it is good to have a rather broad classification of expenses. By segregating your expenses into basic charges you can more easily assemble your figures into any picture you are trying to portray. You will also find that you have more information constantly available in this way. In our bank we use eleven main classifications, with sub-classifications under each. The expense accounts should also be assigned a number, and, if you group your expense accounts, you can reserve a spread of numbers for each group. In this way you can have all expenses of a similar class identified by a group of numbers. For example, you can assign ten or twenty numbers

to a group. To avoid confusion with your department numbers, suppose you start with number 100 and reserve the first twenty numbers for your salary group. No. 100 can be officers' salaries; No. 101, clerical salaries; No. 102, supper money or overtime, and so forth. Then you can start your next group with No. 120. Suppose the second group is stationery, printing, and office sup-

ment as well as the expense account to be charged should be marked on the invoice. We do this by placing a dash between the two numbers, the first number indicating the department and the second the expense account. Most banks use some sort of expense voucher form, to which they attach the invoices to be paid. Although this is not necessary, it is desirable and is generally used to authorize the

EXHIBIT "A"

Departmental Classification

- | | |
|---------------------------------------|----------------------------------|
| 1. Loan | 37. |
| 2. Credit | 50. General Books |
| 3. Bookkeeping (Checking
Accounts) | 51. Auditing |
| 4. Bookkeeping (Country Banks) | 52. Statistical |
| 5. Account Analysis | 53. Files |
| 6. Distribution | 54. Purchasing & Stock Room |
| 7. Clearings | 55. Telephone |
| 8. Transit | 56. Printing |
| 9. Paying & Receiving | 57. Police |
| 10. Collection | 58. Addressograph |
| 11. Draft | 59. Janitors |
| 12. | 60. Mail |
| 13. | 61. Personnel |
| 14. | 62. New Business and Advertising |
| 30. Savings | 63. |
| 31. Safe Deposit | 64. |
| 32. Trust | 65. |
| 33. Foreign | 80. General Overhead |
| 34. Bond | 81. |
| 35. | 82. |
| 36. | 83. |

plies. You can make No. 120 stationery and printing; No. 121, customers' check books; No. 122, office supplies; and so on. By reserving a spread of numbers for each group of expenses you are able to add additional expense accounts, and by using the unassigned numbers, you do not disturb your grouping arrangement.

When invoices are received for payment, the number of the depart-

ment of the invoice. It also makes a neater filing and reference arrangement. If you are using a voucher form, the distribution numbers should be indicated on it. If several bills are paid with one voucher, the distribution should be consolidated; this will materially reduce the posting work later.

Distributing certain classes of expenses, like rent, telephone, and

EXHIBIT "B"

Expense Account Classification

SALARIES	FEES
100. Officers	300. Directors' Fees
101. Employees	301. Legal Fees
102. Supper Money	302. Clearing House Dues
	303. Clearing House Fines
STATIONERY, PRINTING, AND OFFICE SUPPLIES	304. State Department Examinations
120. Stationery and Printing	305. Appraisals
121. Customers' Check Books	INSURANCE
122. Office Supplies	320. Fidelity (Blanket Bond)
123. Furnishings	321. Fire, and so forth
124. Drinking Water	322. Liability and Casualty
125. Towels, Soap, and so forth	323. Group Life
126. Uniforms	340. TAXES—FEDERAL INCOME
127. Janitor's Supplies	TAXES—ALL OTHER
POSTAGE, TELEPHONE, AND TELEGRAPH	360. Personal Property
140. Postage	361. Miscellaneous Taxes and Licenses
141. Local Calls	362. Revenue Stamps
142. Toll Calls	OTHER EXPENSE
143. Telegraph	500. Traveling
144. Leases Wire Rental	501. Donations
145. Ticker Service	502. Shipping Charges, Curr. and Sec.
RENT	503. Association Dues
160. Office Space	504. Credit Agencies
161. Storage	505. Statistical and Research Agencies
162. Light and Power	506. Directories, Magazines, etc.
163. Alterations, Repairs, and Maintenance	507. Library Books
164. Cleaning and Decorating	508. Equipment Maintenance
ADVERTISING	509. Carfare
200. Plain Dealer	510. Taxi and Auto Hire
201. News	511. Attending Meetings and Dinners
202. Press	512. Entertaining and Cigars
220. Out of Town Newspapers	513. Flowers
221. Financial and Banking Publications	514. Lettering and Signs
222. Commercial and Trade Publications	515. Protective Service
223. Magazines and Periodicals	516. Expressage, Freight, Cartage
240. Directories	517. Equipment—Rental
245. Window Decorations	518. Classified Advertisements
250. Outdoor Advertising	519. Salesmen's Expense
260. Programs	520. Exchange
261. Calendars and Blotters	521. Systems and Installation
262. Specialties	540. Emergency Medical
263. Savings Banks	541. American Institute of Banking
264. Folders, Booklets, and so forth	542. Employees' Educational Activities
265. Circulars	543. Employees' Athletic and Social Activities
270. Call Statement Folders	
299. Miscellaneous Advertising	

blanket bond insurance, is perhaps the phase about cost systems that frightens most people, or at least it deters them from getting into the subject. However, when you pause and analyze the problems involved, in each case you will find them rather simple. Once you have established your distribution, you will find that in many cases you can use the same figures or percentages each month. This will apply to the distribution of rent, telephone, and several other details.

The basis to be used in spreading some of these expenses must naturally vary with each item of expense. Rent can be spread on a basis of the square feet occupied by each department. For telephone expense the number of instruments in each department forms a basis used by many banks. Blanket bond insurance can be spread on the basis of the number of employees in each department, and so on.

Stationery, printing, and supplies can be charged to departments at the time of purchase or on a requisition basis at the time the supplies are withdrawn from the stock-room. The requisition basis entails a little more work, but it is a much better method, because the charges are made to the departments during the month in which they are used. Charging items to departments at the time of purchase tends to distort monthly comparisons. A six or twelve months' supply of an expensive form might be purchased at one time, and the cost would appear in one month. This is especially true when a new system is started. The cost of all new forms and binders then appears in one month, and consequently comparisons are made more difficult.

Expenses like directors' fees, president's salary, and taxes do not lend

themselves as readily to distribution, and these can be charged to general overhead. You will find, however, that it is wise to distribute everything possible direct to departments, and to keep items in your general overhead at a minimum. Most items generally charged to overhead can be distributed to departments if some one will do a little analyzing and thinking. The salaries of most of your officers can be distributed, and it is not difficult either. By asking your officers to analyze their time, or even by doing it for them, you can determine to what departments they devote most of their time, and you can charge those departments on a percentage basis. You will be astonished to find how simple some of these things really are.

EXPENSE LEDGER

With the distribution marked on the invoice or voucher forms, you are now ready to post your expense ledger (Exhibit "C"). Any multiple-column sheet will do for the expense ledger. Use a separate sheet for each department, and at the top of each column write the number of the expense account to be charged. Most departments will require only a limited number of your expense accounts, and you will therefore find it best to leave them blank and head them as you need them. It is also possible to use one column for each group of expenses, like salaries, printing, stationery, and supplies, although I prefer a separate column for each account, because if, at a later time, you wish to analyze the detail of some of these items you have the information immediately available. One column should also be used for the date and another for

EXHIBIT "D"
REPORT OF OPERATIONS AND EXPENSES

Transit Department

	May 1930	May 1929	Total to date 1930	Total to date 1929
Expenses				
Salaries	344.00	358.81	1,643.06	1,679.11
Printing and stationery	20.32	26.83	100.01	92.91
Supplies	8.82	8.25	40.11	35.74
Telephone	2.98	2.98	28.56	11.71
Telegraph	1.12	1.43	3.49	2.30
Rent	44.69	44.69	223.45	223.45
Light and power	5 12	5.68	22.64	24.32
Blanket bond and group life in- surance	14.35	14.35	71.75	71.75
Equipment maintenance	20.16	4.30	23.75	12.95
Miscellaneous . . . . .	.....	2.75	.. ..	5.72
Total direct expenses	461.56	470.07	2,156.82	2,159.96
Overhead and service depart- ment cost	441.33	428.17	2,078.14	2,014.36
Total cost	902.89	898.24	4,234.96	4,174.32
Budget Comparison				
Total direct expenses	461.56	.....	2,156.82	.....
Approved budget	440.00	.....	2,220.00	.....
Expense under budget	21.56	... ..	63.18	.....
Operations				
Average number employees	3	3	3	3
Number transit items	41,678	35,010	195,214	170,742
Items per employee per month . .	14,226	11,670	13,014	11,383
Transit department direct ex- pense per item . . . . .	.011	.013	.011	.013
Transit department total cost per item . . . . .	.021	.025	.021	.024

last year and the total to date this year and last year. This will furnish some very interesting comparisons after your report has been in operation for some time. The report can also be made more valuable by adding some statistics regarding each department. The number of employees and the volume of work units handled will be found very interesting. Even the earnings of some departments, like trust, bond, and collections, can be shown, and will increase the value of your report, and make it more interesting and revealing.

MONTHLY RECORD OF ITEMS HANDLED

The compilation of these statistics can be made very simple, so that they will not prove burdensome to prepare. The count of items handled should be made by the department that handles the respective items. Transit and clearing items can be counted by the tape method. Lines on your teller's proof sheet can be numbered when printed, and the daily total checks cashed can then be quickly determined. These totals should be listed daily on a report form, which should be turned in to your expense clerk at the end of the month, after it has been totaled and averaged for the month (Exhibit "E").

I think you will agree that up to this point the procedure has been very simple and that it has not required much effort, but you have assembled a set of figures which give you the direct expenses of each department. Your figures also balance with your general ledger. It is apparent to you, therefore, that all of your expenses are included and that none have been omitted; consequently your expense

report forms an excellent basis for your cost accounting.

CONTROL POSSIBILITIES OF THE EXPENSE REPORT

A little study of the figures will probably astonish you as to what it is costing you to operate some of your departments. After your system has been in operation for a year or more, you will be able to make comparisons with the same month last year and also with your totals to date for this and last year. Here you may discover that, while the volume of postings in your bookkeeping department has remained stationary, the expense of the department has increased twenty per cent. If the increase occurred in the salary item, you know at once where corrective measures need to be applied. If, on the other hand, the number of items handled in the transit department has increased twenty per cent in volume and the amount of expenses has not increased, you know that this department has increased its productive efficiency, and the head of that department is producing good results. You can now see some of the control possibilities of your expense report. It really gives you a complete analysis of your expense account, and the more you study the report the more you will find you can get out of it. If your report indicates a reduction in the total cost of a department or a smaller proportionate increase in cost than your increase in volume handled, you know that the efficiency of that department is improving, and if you can keep it constantly improving you will gradually reach the highest point of efficiency. That is a goal worth achieving.

EXHIBIT "E"

MONTHLY RECORD OF ITEMS HANDLED

MAY 1930
Month

Transit Department

Dep't head or Teller

Date	Assigned Employees			Transit Items					
	Men	Women	Total						
1	1	2	3	1,367					
2	1	2	3	1,251					
3	1	2	3	1,167					
4	...	...	...	...	
5	1	2	3	3,178					
6	1	2	3	1,695					
7	1	2	3	1,847					
8	1	2	3	1,117					
9	1	2	3	1,685					
10	1	2	3	1,943					
11	...	...	...	...	
12	1	2	3	2,941					
13	1	2	3	1,327					
14	1	2	3	931					
15	1	2	3	1,245					
16	1	2	3	921					
17	1	2	3	995					
18	...	...	...	...	
19	1	2	3	2,342					
20	1	2	3	1,879					
21	1	2	3	1,542					
22	1	2	3	821					
23	1	2	3	1,117					
24	1	2	3	1,687					
25	...	...	...	...	
26	1	2	3	1,835					
27	1	2	3	1,679					
28	1	2	3	1,017					
29	1	2	3	1,429					
30	...	...	...	...	
31	1	2	3	3,720					
Total	26	52	78	41,678					
Average	1	2	3	1,603					

COMPARISONS WITH OTHER BANKS

It is advisable to make comparisons with other banks, and you are now in a position intelligently to discuss and compare your production and your production costs with those of other institutions.

In the matter of production figures, you will find that there are definite standards you can measure up to. In the bookkeeping department, for example, a bookkeeper alternating on a set of statements, paying all indorsements, and filing all checks, can easily attain a standard of 16,000 postings a month. I have seen operators handling 19,000 without difficulty or overwork. Production in other departments can be tested in a similar way. While local conditions will have some bearing on your production figures, nevertheless the efficiency of many of your departments can be closely gauged.

By this time you will find your expense report one of the most interesting things in your bank, and the control it affords will amaze you. Your report will tend to create a healthy stimulus throughout your entire organization — once your officers and department heads know that their production and expenses are being studied. This psychological effect is usually very great and is not to be underestimated. Watching the production and expenses becomes a game in which your entire organization participates.

When you reach this stage, you begin to realize the tremendous possibilities of your system, and the cost of installing and operating it becomes infinitesimal by comparison. I have encountered many bankers who have

looked upon bank cost systems as unnecessary, but in each case, after seeing one in operation in their own banks, they would not part with it. One of the things that sells your expense report to the officers who are in charge of various departments is that it gives them a report of the controllable expenditures for which they are directly responsible.

A DEPARTMENTAL BUDGET

You now have real departmental expenses. Some banks do not carry their expense or cost accounting beyond this point. However, after your expense report has been in operation for a period of time, you have an excellent foundation on which to start a departmental budget system. Your budget figures can also be shown on your expense report monthly, and you can compare actual performance with your budget, to see whether expenses are over or under the budget. The results for the current month can be shown, as well as the total for the budget period, and they will add considerably to the usefulness of your report.

PER-ITEM COST ACCOUNTING

If you wish to carry your cost accounting further, it is now a simple matter to find your per-item costs in the various departments. For example, in the transit department, divide the total expense of the department by the total number of items handled. This will give you the direct per-item cost of handling an item in the transit department. If you have a distributing department, the direct per-item cost of handling the transit item in that department must be added to the

direct cost per item in the transit department. You now have the total direct cost per item of your transit items. In a similar manner you can arrive at the direct per-item costs of clearings, collections, and loans.

ALLOCATION OF GENERAL OVERHEAD AND COST OF SERVICE DEPARTMENTS

There is only one further step necessary from a cost accounting standpoint, if you want to know your total cost per item, as distinguished from the direct cost of handling the item; that is an allocation of your general overhead, which you have set up as a separate group, and also an allocation of the cost of service departments (Exhibit "F"). In this final analysis, the general overhead group and the cost of all service departments, such as purchasing, stenographic, personnel, addressograph, filing, mailing, and auditing, must be prorated to the operating departments.

While this step is not necessary from a control point of view, it is necessary if you want to know your total cost per item. Overhead and service department costs must be included when analyzing your accounts or determining the amount of service charge necessary to make a profit on any particular class of items handled. Some banks omit these costs and use only the direct expenses of the departments which handle the item, in computing their service charges. However, in so doing they are underestimating their costs. If such figures are used in analyzing their accounts, the results obtained will be erroneous and misleading, for the reason that some of their actual costs have been omitted. Consequently, their service charges

do not fully compensate them for their cost, much less provide a profit.

While at first thought it may appear as though a great deal of study is necessary properly to prorate the cost of general overhead and service departments, this, too, is not so difficult as it may seem. Your addressograph department can tell you for which departments it spends its time. If it cannot, let it keep a daily time sheet, at least for a period of time, and you can establish percentages from this to be charged to each operating department. These percentages can be used each month until conditions change. You can arrive at percentages for prorating your filing, mail, and audit departments in a similar manner. If you have a personnel department, its cost can be prorated on the basis of the number of employees in each operating department. If you have a janitors' department, its cost can be prorated on the basis of the number of square feet occupied by each operating department.

With the exception of taxes and the cost of the new business and advertising department, all overhead and service department costs should be prorated and included in the various per-item costs, because such costs are closely related to the respective activities.

In analyzing the cost of deposit accounts, taxes and the cost of the new business and advertising department, as well as the cost of the loan and credit departments, should be prorated to each account on a dollar of deposit basis. Instead of doing this at the time each account is analyzed, some banks segregate such costs and deduct them from gross income before figuring the average rate of earnings.

FREQUENCY OF COMPUTATION

Some banks compute their total per-item costs only occasionally or annually, rather than each month. Some do so when they are establishing or

report I have explained will give you ample cost information, and you need not go into the matter of prorating your service department expenses.

When you get into the details of installing a cost system, you will find

EXHIB

DISTRIBUTION OF GENERAL OVER

	Total Expenses	(These Items Deducted from Gross Earnings for Account Analysis Purposes)			Book-keeping (Checking Accounts)	Book-keeping (Country Bank Accounts)	Account Analysis
		Account Overhead-Checking and Country Banks	Loan	Credit			
TOTAL DIRECT EXPENSES	9,021.51	...	909.16	928.05	1,013.35	137.59	157.30
INDIRECT COSTS							
General books..	430.28	.....	137.69	.....	25.82	30.12	.....
Auditing	804.23	.....	281.48	.....	40.21	40.21	.....
Statistical....	618.71	.....	154.68	154.68	.....	.....	.....
Files.....	144.97	.....	29.00	7.25	2.90	10.15	8.70
Purchasing and stock room ..	308.42	.....	46.26	18.51	21.59	9.25	6.17
Telephone..	140.82	.....	7.04	7.04	9.86	1.41	2.82
Printing.....	167.70	.....	25.15	10.06	11.74	5.03	3.35
Police.....	445.00	.....	44.50	.....	.....	.....	.....
Addressograph ..	301.82	.....	.....	.....	45.28	15.09	15.09
Janitors....	266.40	.....	39.96	15.98	18.65	7.99	5.33
Mail	564.66	.....	28.23	28.23	28.23	16.94	11.29
Personnel	378.22	.....	18.91	26.47	45.39	7.56	7.56
New business and advertising. .	1,542.83	925.69	.....	.....	.....	.....	.....
GENERAL OVERHEAD							
Salaries	2,550.00	.....	1,275.00	637.50	51.00	25.50	25.50
Federal income tax.	916.32	430.67	.....	.....	.....	.....	.....
Other taxes.....	1,038.57	706.23	.....	.....	.....	.....	.....
Other expenses.....	816.62	.....	285.82	40.83	204.15	40.83	8.17
TOTAL INDIRECT COSTS..	11,435.57	2,062.59	2,373.72	946.55	504.82	210.08	93.98
GRAND TOTAL COSTS. .	20,457.08	2,062.59	3,282.88	1,874.60	1,518.17	347.67	251.28

reviewing some of their service charges. These things each bank can determine for itself. If you are interested in a cost system only from the standpoint of management control and efficient operation, the expense

it immensely interesting, and you will be astonished to find how simple it is to operate, and that it does not require a certified public accountant to install a method such as I have outlined to you. Any one of your senior

men with accounting background can easily work out the details and install it in your bank, or you can have a junior doing the detail work if the senior will do the planning and thinking part of the job. One of the most

your basis is correct.

Cost systems and the studies they entail have been successfully applied in many banking institutions with outstanding results in cost reductions, increases in operating efficiency, and

IT "F"

HEAD AND SERVICE DEPARTMENTS

Distribution	Clearings	Transit	Paying and Receiving	Collections	Drafts	Savings	Safe Deposit	Trust	Foreign	Bond
385.57	281.74	461.56	1,178.22	168.03	180.82	263.13	266.34	1,252.75	201.07	1,236.83
12.91	12.91	12.91	43.03	12.91	55.94	30.12	8.61	12.91	12.90	21.50
16.08	24.13	32.17	40.21	16.08	8.04	40.21	24.13	80.42	40.21	120.65
..	..	7.25	..	21.75	..	4.35	2.90	92.81	61.87	154.67
9.25	6.17	9.25	30.84	6.17	6.17	15.42	9.25	7.25	14.50	28.97
2.82	4.22	4.22	9.86	4.22	2.82	7.04	7.04	46.26	30.84	37.02
5.03	3.35	5.03	16.77	3.35	3.35	8.39	5.03	23.94	7.04	39.43
..	..	..	178.00	4.45	4.45	35.60	44.50	25.15	16.77	20.15
..	..	75.45	..	..	..	15.09	15.09	44.50	22.25	66.75
7.99	5.33	7.99	26.64	5.33	5.33	13.32	7.99	90.55	..	30.18
..	..	197.63	..	28.23	..	28.23	28.23	39.96	13.32	45.29
30.26	18.91	30.26	34.04	7.56	7.56	15.13	7.56	56.47	28.23	84.72
..	..	..	..	..	..	77.14	30.86	52.95	11.35	56.75
..	..	..	..	..	..	..	..	262.28	15.43	231.42
25.50	25.50	51.00	51.00	25.50	25.50	25.50	25.50	102.00	51.00	127.50
..	..	..	..	..	..	91.63	9.16	137.45	18.33	229.08
..	..	..	..	..	..	103.86	10.39	51.93	41.54	124.63
8.17	8.17	8.17	8.17	16.33	16.33	24.50	24.50	40.83	16.33	65.32
118.01	108.69	441.33	438.56	151.88	135.49	535.53	260.74	1,167.66	401.91	1,484.03
503.58	390.43	902.89	1,616.78	319.91	316.31	798.66	527.08	2,420.41	602.98	2,720.86

important things in cost accounting is to be sure that none of your costs have been omitted. In the method I have described to you, your expense report is balanced with your general ledger; therefore, you are sure that

sound administration policies, so much to be desired.

Your executive officers will find that, by a careful perusal and study of the expense report each month, many weaknesses and leaks in the

institution will be discovered. If it is properly operated and studied, you will find that with it you can, so to say, feel the pulse of the operating efficiency of your institution, because it presents you with a clear picture of your expense account and a control over your operations not otherwise obtainable.

Discussion

THE CHAIRMAN: When Mr. Huelsman sent me the original copy of this address, I asked him if he would kindly have some forms made up which would show the way these various costs are distributed, show some of the mechanics of the installation of this type of cost system. I criticized his address to a certain extent, as I thought it applied largely to banks of a few millions in deposits rather than a few hundred thousand. He very graciously arranged to have the address printed with all the forms and told me that the only difference between the application of this system to a large bank and its application to a small bank was the number of different accounts and departments to which the expenses would be distributed.

You will find in this pamphlet, which is available to you, a number of forms which will show all that you want to see in regard to the application of this type of cost system. If there is any one thing necessary in the banking game today, as I see it, especially in the small country bank, it is to know what things cost.

N. S. NORTH (First National Bank, Lake Charles, Louisiana): I should like to bear out some of the statements just made, in that the results would be startling. They will

knock you cold. Only as recently as the month of April we made an analysis of our costs, and I just jotted down a figure or two that I thought might be of interest to some of you.

Our earnings were not as much as they should be, we thought, on our capital structure. We set out to discover why they were not. One of the first things we did was to try to ascertain what rate we were paying for money that was derived through our bookkeeping department or deposits, considering that as raw material. Our cost system or cost analysis shows that we were paying over 4½% for money derived from the bookkeeping department, which is too high. No bank can pay 4½% for money and make any money out of loaning it.

We then segregated our accounts into individual, commercial, and other accounts. We classified those according to balances. We found that in our individual accounts the activity of accounts under \$100 for the month of April constituted over 35%. In other words, 35% of the total cost of our bookkeeping department was directly attributable to individual accounts with balances of less than \$100. These same accounts controlled only 3% of our deposits. There is a nice comparison: 35% of our costs controlled only 3% of our deposits. To make that more plain, those accounts drew over 9,000 checks, and the balances in those accounts were \$24,000.

If any of us here had one account on our books that drew 9,000 checks in one month and made several hundred deposits and carried only a \$24,000 balance, I think we would go and see our client about it and ask him to do something. But it is worse

than that. Instead of only one account, in this case over 600 accounts were active. That requires at least the time of one bookkeeper, and, instead of one or two ledger sheets, 600 ledger sheets, 600 statement sheets, and a corresponding number of envelopes and stamps. You can see that this is a tremendous loss to the bank and is part of the high cost of that money.

The banks of Lake Charles have a flat charge of fifty cents a month on these accounts. That is not an equitable way of distributing that cost, however. Our banks charge fifty cents a month for accounts under \$100. A \$100 account may draw two checks. It pays fifty cents. Another account may have \$15 and may draw fifty checks, and it also pays fifty cents; therefore the only equitable way to distribute those charges, in my opinion, would be on a cost-per-item basis.

I thought those figures might be interesting. Of the accounts under \$500, including commercial accounts and individual accounts, 70% of our activity controlled only 15% of the deposits. If there are any others here who have made a similar analysis, I should enjoy comparing the figures.

HAROLD D. COTHRELL (First & Tri-State National Bank & Trust Company, Fort Wayne, Indiana): We also made an analysis of our bookkeeping department. One of our twenty ledgers has 667 accounts, and 15% of these accounts are carrying 95% of the total balances of that ledger. Some 94 accounts are carrying 95% of the total balances of the ledger.

Also, in connection with cost accounting, the analysis of accounts is astonishing. We analyzed for ten days one of our accounts that we

thought a rather profitable account to us, carrying an average balance of between \$10,000 and \$15,000. We found that the account cost us \$45 to carry for ten days—over \$1,400 a year loss on that one account alone. That is what a cost system will show.

GLENN C. COLE (Mercantile Bank & Trust Company, Dallas): I should like to ask one question. I was particularly interested in learning what method you used in attempting to prorate your tellers' expense to the transit and bookkeeping departments—all tellers, receiving and paying.

MR. HUELSMAN: There are several ways in which you can do that. First, you have to determine what your tellers are there for. In other words, it will depend to some extent on what your tellers are doing and how they are functioning. If your distributing department, for instance, is handling and breaking down your deposits, your tellers will not be handling your checks deposited. I think the larger banks are operating in that way. The teller is only handling your deposits and cashing checks, not balancing the items or inspecting them, except casually. In that case, I should say that a certain per cent of the cost of your tellers should be distributed to deposits, and a certain amount to checks cashed. You can arrive at a percentage basis and determine how much of the teller's time is taken up by deposits, whether there is a great deal of cash in deposits, and so forth. You might want to prorate 80% to deposits and 20% to checks cashed. The only place you would use the teller's cost in such a case would be in computing the cost of the debits and credits handled in the bookkeeping department. You would add the cost

of handling checks cashed at the window to the cost of handling them in the bookkeeping department and divide that cost by the number of items handled. You can use the same method for deposits.

Some banks go even farther and try to figure out the cost of a deposit containing cash against one not containing cash: certain accounts never bring in any cash, and certainly it is costing you money to handle cash at your windows.

W. H. LINDSAY (Provident Trust Company, Philadelphia): I think that prorating the taxes is the most difficult thing. How do you do it?

MR. HUELSMAN: I outlined that in the report. Taxes, I think, are not related to activity, and, therefore, I would not include them in per-item costs. I think your taxes should be spread over each account on a dollar of deposit basis.

MR. LINDSAY: May I ask how you allocate the taxes to the different departments—not necessarily the ratios, but what method you use?

MR. HUELSMAN: That is perhaps the most arbitrary thing in cost distribution and will be so in any distribution. Income tax is relatively simple. You can prorate the income tax to each department (basis, the federal income tax report), determine how much income your trust department, for example, contributed to your net income last year as compared with the total, and charge it for income tax on that basis.

MR. LINDSAY: Using gross figures rather than net?

MR. HUELSMAN: No; you have to use net figures, because your income tax is paid on net income.

MR. LINDSAY: What if the trust department shows a loss?

MR. HUELSMAN: If it shows a loss you should not charge it for income tax. It has no income.

MR. LINDSAY: How about capital taxes?

MR. HUELSMAN: I think the simplest thing to do with capital and personal property taxes is to deduct them, together with your loaning cost, from the gross income of the bank, before figuring the rate of return on earning assets, allow the trust department that rate for cost purposes, and your taxes are automatically distributed.

MR. LINDSAY: Thank you.

DAMIEN DUCY (Southern Colorado Bank, Pueblo County, Colorado): I should like to ask about the item of rent. When you own your own building, do you merely set up as rent the depreciation, taxes on that part of your capital invested in the building, and a reasonable return on your investment, or do you compare it with similar properties and the rent return they bring; and then, too, in allocating the rent, do you, in figuring the space, take into consideration the lobby or the actual work space?

MR. HUELSMAN: I will answer the last one first. In distributing the rent, you can do it either way. Some banks eliminate lobby space, and some will charge their lobby to those departments which need it—commercial tellers, savings, and so forth.

I am glad you brought up the matter of owning your building. Some banks are very much underestimating their costs, because they are not including a proper rent charge in their cost figures. In other words, they own their building and they are charging themselves a nominal amount of rent, just enough, perhaps, to balance the operating expenses of the building. That means that they are entirely

ignoring the fact that they have a certain investment in that building. The bank should pay rent on an appraisal basis of what the space is actually worth, and that figure should be included in its per-item costs.

When you want to know what return you are receiving on your building investment, you will have the correct picture, too. If you pay yourself rent, perhaps you have some tenants in the building to take the total rent received and on the other side take the operating expenses and taxes, and you will see what kind of net return you have on your building investment.

LOUIS SCHAEFER (Boulevard Bridge Bank, Chicago): In connection with Mr. Huelsman's talk on distribution of expenses, there is no question but that the standardization of the distribution of expenses is a bugbear. This has been brought out in the reports of the American Bankers Association from time to time. There have been conferences in Washington and other cities to establish a uniform system for the allocation of expenses, principally the overhead expenses.

In the Chicago Bank Auditors' Conference within the coming year we expect, through the leadership of Mr. Brunkhorst, Past President of the National Association of Bank Comptrollers and Auditors, to establish a standard or uniform system for

the distribution of various expenses, federal tax, income tax, and what not. We hope that in the coming year we shall have something to present to the American Institute of Banking in the way of a report.

THE CHAIRMAN: I should like to ask the ladies and gentlemen assembled here to answer three questions if they can. I want to count the number of hands held up in answer to each question.

1. How many banks have a cost system that brings down their expenses to the cost per item?

. . . Twenty-one hands were raised . . .

2. How many banks deduct float? I mean, in figuring the value of a balance or the earning power of a balance, is the float or money, checks in process of collection, deducted before that balance is arrived at?

. . . Approximately forty hands were raised . . .

3. How many banks haven't a cost system, but as a result of the activities of the various bankers' associations and of the Bank Management Commission and other organizations, are planning to install a cost system and arrive at per-item costs within the near future?

. . . Approximately fifteen hands were raised . . .

THE CHAIRMAN: Thank you very much.

Interest on Accounts—Commercial and Savings

By A. C. BURCHETT

CASHIER OF THE BANK OF COMMERCE AND TRUST COMPANY,
MEMPHIS, TENNESSEE

Address before the Denver Departmental Conference

Mr. Burchett believes that the subject of interest rates on deposits requires careful study, since the tendency in the matter of operating costs has been upward. Accounts must be analyzed on a scientific basis, and the payment of interest must be founded on such an analysis.

Mr. Burchett reviews the four methods for computing interest on savings accounts which were formulated by the Savings Bank Division of the American Bankers Association. From the four approved methods, we should be able to work out a method to suit our own needs.

"Banking service offers substantial advantages to savings depositors, but a bank must have a safe margin upon which to operate, a margin sufficient to cover expenses, risks, and so forth, and something for compensation; any business which cannot be had on this basis should be considered as undesirable to the banker."

THE subject of interest rates on deposits is one that demands attention. The general trend of interest rates at the present time is downward, while, on the other hand, the ordinary operating expenses of the banking business, in which salaries and taxes are the leading items, have not declined, and there is nothing to indicate that they are likely to do so.

With the many changes that have come about in the last few years in the banking business, the tendency in the matter of operating costs has been upward, and it is evident that there must be a middle ground somewhere between income and outgo, the latter including a reasonable return upon capital invested, if the banking business is to be kept on a sound basis. Banking income is chiefly in the form of interest, and one of the largest

items of outgo is interest on deposits.

In an analysis chart prepared by H. N. Stronck & Company, as of December 31, 1928, it was shown that members of the Federal Reserve System paid out 32.8% of their income as interest on deposits; and this does not include interest paid for borrowed money. A report compiled by the Federal Reserve Board showed that in the fiscal year ending June 30, 1927, the gross earnings of all the member banks of the Federal Reserve System aggregated \$2,068,870,000 of which \$1,723,487,000 was interest. Expenses aggregated \$1,475,201,000. Losses minus recoveries were \$154,252,000, and dividends aggregated \$292,066,000, leaving \$147,351,000 as a margin of safety.

The aggregate gross income of all

banks was \$6.44 to each \$100 of earning assets, and of that amount \$5.37 was interest and \$1.08 was other earnings. Expenses are summarized as follows:

Interest on deposits...	\$687,021,000
Interest on borrowed money	29,363,000
Salaries and wages...	408,048,000
Taxes	109,708,000
Other expenses	241,061,000
Total expenses ...	\$1,475,201,000

Interest paid on deposits amounted to 46.57% of total operating expense and to nearly 40% of all interest receipts. It is therefore clear that the banking business lives mainly upon the margin between interest received and interest paid, and the relation between the two is of vital importance. Interest rates on deposits should be based on current earnings and not on past performances. Of late years in the banking business we have learned many things about profits, but we have learned nothing more significant than this: that the basic reason for success or failure is not an economic condition, not environment, not location, but management. During the past twenty years the striking growth of deposits has been equaled only by the equally striking failure of banks to make commensurate profits.

There seems to be no uniform basis for the payment of interest on commercial accounts. Some banks pay interest only on city and state funds; others pay on balances of certain fixed amounts; while still others have no basis at all other than the demands of their customers. The application of certain rules for the payment of interest has enabled many banks to reduce materially their in-

terest expense. With the trend of interest income downward, a bank should decide definitely what it can afford to pay for the use of money in this department, giving due consideration to the variety of service it must render to customers in conjunction with their accounts.

Some think it is not advisable to make a wholesale elimination of interest, but recommend that interest be paid only on such accounts as show by an analysis a profit to the bank after the payment of interest. Originally, the fundamental principle of commercial deposits was that the earnings on these deposits would recompense the bank for the special services rendered, and very little or no interest was paid on commercial accounts. Present-day competition, however, has compelled banks to pay interest in order to retain certain of their accounts. The elimination of harmful competition through cooperation will be of material aid in preventing this practice and will prevent the payment of interest on any accounts except those which produce a profit in excess of the interest paid. In many sections of the country clearing house associations have designated the minimum balance to be carried if interest is desired. While this is a step in the right direction, it is by no means a complete remedy for the present situation. It does prevent the payment of interest on small accounts, but in many cases the bank may be making more profit on these small accounts than on the larger ones on which it does pay interest. There may be more profit in a small account of \$500, which is relatively inactive, than in an account maintaining a balance of \$5,000 which has a large float and great activity.

The commodity in banking is dollars, which are bought and sold. The accounts should be kept so as to reflect the price at which they are sold (interest income) and the price at which they are bought (interest expense). This will enable the average banker to keep in mind the gross profit which he makes, from which all expenses of operation and losses must be paid. Some think interest paid should not be considered as a part of the cost of operating the bank, but as a part of the cost of obtaining the funds with which to conduct banking operations. Income from other sources, profits from securities sales, and so forth, represent the return obtained as the result of the ability of the individuals operating the bank rather than additional income from the use of funds. In more than one case it has been found that there is very little margin between interest income and expense, but that profits from securities sales, commissions, and similar items have hidden this fact from the bank executives.

There is a lack of uniformity in the rates and the methods of computation of interest on time deposits. There seems also to be a prevailing custom among commercial banks to follow the lead of savings banks in the payment of interest. The basic factors underlying these two types of institutions are entirely different. Most mutual savings banks have accumulated large surplus and reserve accounts. The return from the investment of these accumulated funds is usually more than sufficient to pay operating costs, absorb losses, and increase reserves. Therefore, it is possible for the entire return from the investment of depositors' funds, which

may be as much as 5% per annum, to be paid as interest on deposits. Such banks can continue to thrive and pay high rates on their deposits.

To summarize: a mutual savings bank need earn only enough from the investment of its deposits to pay interest (dividends) and a comparatively small operating expense; whereas a commercial bank must earn a sufficient income from the investment of time deposits to:

1. Absorb losses from investment of these funds
2. Pay cost of operating savings departments
3. Pay interest to depositors
4. Absorb this department's portion of taxes and similar items, and so forth
5. Leave a profit for stockholders.

As a result of detailed analysis of the savings departments of 92 banks, it has been determined that the average bank, in raising its rate of interest payment from $3\frac{1}{2}\%$ to 4%, must increase its savings deposits $33\frac{1}{3}\%$ without any increase in expense, to earn the same profit.

If this statement is reversed, the facts would be as follows: The interest rate may be reduced from 4% to $3\frac{1}{2}\%$ and deposits fall off to the extent of 25%, expenses remaining the same, without reducing the bank's earnings. If the interest rate is reduced from 4% to 3%, these deposits may shrink 40%, expenses remaining the same, without reducing the bank's earnings.

The schedule which follows shows the facts on which these conclusions are based. It will be noted that the average profit on savings deposits is .49% of these deposits in banks paying 4% interest. This is \$.49 per average \$1,000 on deposit per

year, before providing for any losses or profits arising out of the investment of these funds.

Assuming that the savings or time deposits average \$3,000,000 during the year, and that the rate of interest payment was 4%, the following would have been the result of the year's operations in this department (the percentages used are the averages obtained from special analytical cost surveys):

Interest earned—gross @ 5.276%.....	\$158,286.80
Interest actually paid @ 3.74%.....	\$112,200.00
Investment cost	18,786.60
Savings department expenses.....	12,600.00
Profit .....	.49%
	<u>\$14,700.20</u>

If the rate of interest payment were reduced to 3½%, and as a result thereof time deposits fell off 25%—to \$2,250,000—expenses remaining the same, the following would have been the result of the year's operations:

Interest earned—gross @ 5.276%.....	\$118,704.95
Interest actually paid @ 3.24%.....	\$72,900.00
Investment cost	18,786.60
Savings department expenses.....	12,600.00
Profit .....	.64%
	<u>\$14,418.35</u>

If the rate of interest payment were reduced to 3% and as a result thereof time deposits fell off 40%—to \$1,800,000—expenses remaining the same, the following would have been the result of the year's operations:

Interest earned—gross @ 5.276%.....	\$94,971.96
Interest actually paid @ 2.74%.....	\$49,320.00
Investment cost	18,786.60
Savings department expense.....	12,600.00
Profit .....	.79%
	<u>\$14,265.36</u>

During the past few years bankers have had their eyes opened to many facts, and some have had the courage to make a start, at least, to plan and manage their banks, instead of allowing their patrons to dictate what they should and should not do. Many of us have seen our deposits double and double again, but we have also noticed the increased ratio of deposits that our savings and time certificates bear to our total deposits.

During the past five years the Savings Bank Division of the American Bankers Association has had the big objective ever before it of standardizing, in so far as possible, the methods of computing interest on savings deposits.

The result of a survey of 1,000 banks showed that 52 different methods of computing savings interest were used by these banks. The Executive Committee, after a careful study, formulated and approved four methods, which it considered were

fair not only to the banks but to the depositors as well. These methods have been printed and distributed to every member bank of the Association. I presume that most of you are familiar with the four approved methods, but for fear they are not clear in your mind I present them herewith.

METHOD "A"

Interest is to be compounded and credited semi-annually, and is to be paid from day of deposit on all sums remaining in the bank until the end of a quarterly period, provided they have been on deposit for at least one calendar month preceding the semi-annual interest date. Withdrawals are to be deducted from latest deposits. No interest will be allowed on withdrawals made during the six months' period.

METHOD "B"

Interest is to be compounded and credited semi-annually and is to be paid from date of deposit on all sums remaining in the bank until the end of the semi-annual period, provided they have been on deposit for at least one calendar month preceding the semi-annual interest date. Withdrawals are to be deducted from latest deposits. No interest will be allowed on withdrawals made during the six months' period.

METHOD "C"

Interest is to be compounded and credited semi-annually, and is to be paid from the first of each month on all sums remaining in the bank until the end of a quarterly period, pro-

vided they have been on deposit for at least one calendar month preceding the semi-annual interest date. Deposits made after the first of each month will draw interest from the first of the following month. Withdrawals are to be deducted from latest deposits. On withdrawals, interest will cease on first day of quarter in which withdrawal is made, provided no deposits have been made in the quarter.

METHOD "D"

Interest is to be compounded and credited semi-annually, and is to be paid from the first of each month on all sums remaining in the bank, until the end of a semi-annual period, provided they have been on deposit for at least one calendar month preceding the semi-annual interest date. Deposits made after the first of each month will draw interest from the first of the following month. Withdrawals are to be deducted from latest deposits. No interest will be allowed on withdrawals made during the six months' period.

You will note that two of these methods—"A" and "C"—use the quarterly period for computing interest, although crediting same only semi-annually. You will see that Methods "B" and "D" use the semi-annual basis. You will also note that Methods "A" and "B" allow interest from date of deposit, and that the other two allow interest from the first of the month. In the four, all withdrawals are deducted from latest deposits, and all require a deposit to be in one full calendar month to earn interest. From the four approved methods, we should be able to work out a method to suit our own

needs. First, we must decide whether we will allow interest from date of deposit or from the first of the month. Paying from date of deposit has the merit of being accurate and precise, but it will require a great deal of detail work in the making of calculations. I feel that interest paid from the first of the month is simpler to compute and should fit, at least closely enough, into the plans, purposes, and earning dates of most savings depositors.

COMPETITION OF BUILDING AND LOAN ASSOCIATIONS

In some localities bankers hesitate to reduce interest rates upon deposits because of the competition of building and loan associations. As originally conceived, these associations were organized as cooperative institutions to aid in home-building. When run on an economic basis, they serve a useful purpose. If confined to this plan, they do not need to keep cash reserves, but if they enter the banking field and assume such obligations as the repayment of deposits on demand or short notice, it would seem to be obvious that all the safeguards and requirements which apply to banking institutions should apply to them. The remedy for their competition is not in permitting them to make the terms upon which banking shall be conducted, but in requiring them to conform to the conditions which are deemed necessary to safe banking.

Banking service offers substantial advantages to savings depositors, but a bank must have a safe margin upon which to operate, a margin sufficient to cover expenses, risks, and so forth, and something for compensation; any business which cannot be had on this

basis should be considered as undesirable to the banker.

The figures and statistics as quoted herein have been taken from the Survey of Banking Operating Ratios which has been prepared by the Clearinghouse Section of the American Bankers Association.

Discussion

E. V. KRICK (American Trust Company, San Francisco): Did you find, Mr. Burchett, that as a general rule clearing houses regulate the payment of interest on commercial accounts?

MR. BURCHETT: To a great extent they do, Mr. Krick. We find that, where they have been paying interest promiscuously throughout the country, the clearing houses are sitting up and taking notice of the matter and are regulating it.

MR. KRICK: Do you find that in savings or time deposits the banks usually pay interest on from \$1 up, or have they a starting point of, say, \$10?

MR. BURCHETT: I couldn't answer that right off for you, but, so far as I know, in our section of the country they don't pay interest on any time certificate under \$100.

LARRY DURAND (First Minneapolis Trust Company, Minneapolis): We pay interest on time deposits for any amount; and on savings, also.

HARRIS M. HOOVER (Peoples Bank, Enola, Pennsylvania): When I took charge of the bank just organized, I asked my board of directors to put the rate at 3%. They said they couldn't do it. We are a railroad town, and the railroad has a savings department that is paying 5%. We are within five miles of the City of

Harrisburg. The State Capital Savings and Loan Association pays 5%. Some of the directors said, "We have our money in those institutions. We will not take it out and give it to this bank at 3%." I could only hold it down to 4%. I tried 3½%, but they wouldn't even come to that. They said we must pay 5%.

The building and loan associations are a thorn in the flesh in our community. They are not regulated by the state banking department. They have privileges that the banks do not enjoy, and they advertise in the daily papers that they will take care of the 4% tax imposed upon other banks. Some banks have come to the point where they are willing to do that also, because these savings associations are doing it.

GEORGE D. MONROE (Examiner, Detroit): In Michigan most of the banks start paying interest on the savings accounts from \$1 up.

MR. KRICK: I should like to ask Mr. Burchett if he found out whether or not banks put commercial accounts through a probationary period before they agree to pay interest. A firm opens an account for, say, \$10,000. Without knowing what the activity in the account would be, or the float, would the banks agree to pay a certain rate of interest, or wait two or three months until the account had been analyzed to find out whether they could pay interest or not?

MR. BURCHETT: The condition that exists is deplorable. They would not. In their anxiety to get business, competition has made a good many banks do these things which they are doing at a loss.

The building and loan associations in our state are under the state bank-

ing department. They, however, are permitting this, but we are going to make them stop it. That will be one relief.

MR. KRICK: In analyzing accounts, while float is deducted in paying the interest on the account, is activity also considered? There might be a free balance after the float has been deducted, but there might be also a tremendous activity in the account. Is there a charge made for the activity in the account before interest is paid?

MR. BURCHETT: We have not made such a charge, but is it being made elsewhere. One of our big customers who came to see me the other day was very much exercised over the fact that a bank where he had been carrying a very large balance had recently assessed him for the activity of the account. It is coming to that.

RICHARD C. HUELSMAN (The Midland Bank, Cleveland): I was very much interested in the speaker's address, and particularly in two points which he brought out. One is the fact that the way to find out whether you could pay interest on an account is to figure what the account is costing you. If you take the account and analyze the float and deductions, and then the activity on the basis of the volume of items handled, you may find that the account is a loss to you. In addition to that, you may be paying interest. Such analysis is one of the best ways of controlling interest expense.

Another way is cooperation between the banks, especially in the same city. In Cleveland I happen to be head of a committee which is investigating just this subject. We are making a study of the costs in the

various banks, detailed per-item costs, with a view to setting up a uniform formula for analyzing accounts. When we get through, we expect to have the cooperation of every bank in Cleveland in analyzing its costs, and we shall insist that each account pay its own way and that no interest be paid on accounts unless they are profitable and that if accounts are not profitable they be subject to a service charge, not only to cover the expense, but also to include a profit. I think that is the solution.

MR. BURCHETT: In the City of Memphis we have an ironbound clearing house. When we make a rule, we stick to it. Many years ago we found out that we were doing business in Memphis for our customers and not for our stockholders. We were paying interest on deposits. We quit. The only interest we now pay on deposits in the City of Memphis is to the state, to the city, to the county, to the railroad companies, to some life insurance companies, and to certain accounts that we elected to pay interest on when we put this rule into effect. On any commercial account that has been opened in Memphis since 1911, we do not pay a dollar of interest. We don't take any checks from our customers except on certain discretionary points, unless we charge exchange. Therefore, we don't have to go to all this tremendous trouble of analyzing our accounts unless we want to look into them very closely, which we now and then do.

To our country bank customers we pay a rate that is based upon the clearing house rate, one-half of whatever the clearing house rate is. At the present time in Memphis it is 2%. On our savings deposits we pay 3%.

We have a sliding scale on certificates of deposit. On one year we pay 4%. On anything less than that we pay 3%. We pay nothing at all on a thirty-day certificate. For over thirty days and up to ninety days we pay 2%; on ninety days, 3%.

From the way the interest rates are going, I think we are going to reduce this rate. We have a clearing house that has the backbone to do these things, and the people accept them. I have for many years been active in the Tennessee Bankers Association. One of the things we have been preaching to the country bankers, if I may call them that, is that they should form clearing house associations. Tennessee is now divided up, by the various counties, into clearing house associations, and they are regulating the interest rates and staying by them. In other words, we believe in Tennessee that we are getting banking on a pretty good, sound basis. Therefore, you can see that it is pretty hard for me to talk on paying interest on deposits.

MR. HOOVER: In regard to the clearing house association, our state bankers' association has been working on that line and trying to encourage different groups of banks to form such a clearing house. The oldest bank in our community is off at one end of Cumberland County, right across the river from Harrisburg. There are about seven banks there altogether. The banker of the oldest bank used to invite the cashiers, and also some directors, if we cared to bring them along, to a dinner once in a while to talk over different subjects, but he couldn't get us together. Some of the fellows couldn't come, and eventually the thing died out. He tried his best to get that group of

banks interested in one another and to discover the duplication of loans, referred to a while ago, but jealousy prevented such cooperation.

MR. BURCHETT: Your increase in taxes and expense will bring it about.

RAYMOND W. RING (Central National Bank, Oakland): Do you know of any movements to fix the interest paid on commercial accounts on some fluctuating basis, such as the Federal Reserve rediscount rate? As the rate goes up, you would pay more interest on your accounts, and as it goes down, less interest.

EDWARD F. LEBRETON (Hibernia Bank & Trust Company, New Orleans): Is the increase in time deposits an increase in savings, or in certificates of deposit? In our own city we have seen a tremendous increase in certificates of deposit, but not a really substantial increase in the regular savings accounts.

MR. BURCHETT: We have been very much surprised in the City of Memphis at our increase in savings deposits, but we have had the same experience that you have had: our certificates also have increased considerably.

Chain Store and Other Branch Accounts

By CLARK G. MITCHELL

VICE PRESIDENT OF THE DENVER NATIONAL BANK, DENVER, COLORADO

Address before the Denver Departmental Conference

Mr. Mitchell realizes that there has not been complete friendliness between the chain store organizations and their banks, but he feels that the problem is largely one of education, for the banker as well as for the chain store operator. The chain store is a sound economic method of distribution of the world's goods, and, as such, is here to stay.

It is true that many bankers have been called upon to perform extraordinary services with little or no compensating balance or other remuneration. But there is another side to the question. The chain store official finds no uniformity of charges or of requirements on the part of bankers. The bankers themselves do not appear to be acquainted with their own costs of operation, or with the conditions under which their accounts would be found to be profitable.

Some of the chain stores are making every effort to cooperate with their banks and to establish a friendly relationship with their communities.

If the demands of the bankers are reasonable and are based on actual figures, these national organizations will be more than willing to meet them.

THE subject Chain Store and Other Branch Accounts is one that is particularly interesting to me, as my experience with this type of business has been unusually pleasant. I will begin by saying just a brief word about conditions as they appear to exist.

During the last ten or fifteen years a new method of distribution has come into prominence. It is known as the chain store system. In many quarters it is welcomed; in others, it is maligned. Communities have even gone so far as practically to create an embargo against it. Some chambers of commerce have held indignant meetings. Others, that may be more

far-sighted, have opened wide their portals and welcomed a newcomer into their midst. Radio stations have broadcast night after night propaganda against them, yet many national programs are listened to with interest where the chain store itself is the host. Communities are divided by sentiment for and against. Sometimes those that make the greatest noise steal covertly into the foreign organization's place of business and make their purchases.

THE CHAIN STORE A SOUND
METHOD OF DISTRIBUTION

What is going to be the outcome?

Is the system sound or is it a passing fad? These are the questions that will have to be answered by time and experience. My own feelings are that the chain store is here to stay, and that it is a sound economic method of distribution of the world's goods. I even go so far as to believe that its competition will be fair, but that it will require efficiency to meet its own efficiency. It will require skilful volume purchasing to meet its purchase price, and it will require economical handling, also in volume, to meet its selling price.

One of the criticisms often heard is that all of the money received by these organizations is money gone from the community forever, deliberately taken from local business. Let us see whether this is true. Let us analyze the chain store dollar. Various estimates of the distribution of the money received from sales are made by the different companies, but they usually run something like this: 65% goes to the manufacturer, 12% to payroll, 9% to rent, and the balance, up to the 5% of net profit, goes into incidental expenses, such as light, heat, repairs, and so forth, and is spent in the community. The 65% cost of manufacture is sometimes spent in the community, or in nearby cities. Here in Denver one of the large national distribution corporations buys everything locally that can be purchased in competition with its purchases elsewhere. Many of our local manufacturing concerns have received a tremendous stimulus from the chain store purchases. As a matter of fact, these same products were not purchased locally before this company arrived upon the scene.

But I am not here to discuss the various systems of distribution, nor do

I think that a comparison between branch office or chain store distribution and that of the independent merchant comes within the scope of my remarks. There is much to be said on each side.

ATTITUDES OF BANKERS TOWARD CHAIN STORE ORGANIZATIONS

Most of you have branch accounts and perform services for chain store organizations. Many bankers have complained of the extraordinary services they have been called upon to perform with little or no compensating balance or other remuneration. At one time a questionnaire was sent out in order to ascertain the attitude of the banks toward this type of account. Later on a meeting was held in Chicago, at which representatives of the American Bankers Association and officials of a number of the largest chain stores were present. The meeting was called in order to effect a better understanding between the bankers and the national organizations, to the end that their relationship would be mutually beneficial.

The results of the national questionnaire were read to the chain store officials, and these were not entirely complimentary, and did not unanimously state that their accounts were profitable or satisfactory. When they did indicate satisfaction, a scrutiny of the questionnaire indicated that the banker had not analyzed his accounts and was therefore not in a position to know whether the business was good or bad. Contrariwise, it is quite probable that some of the unfavorable comments were unjustified for the same reason. This meeting was reported in a brief article in the January 1930 number of the

Journal of the American Bankers Association by Hal Y. Lemon, Chairman of the Commission on Banking Practices and Clearinghouse Functions. Suffice it to say that the banks endeavored to show the other committee that an efficiently run country bank could hardly break even on the smallest possible chain store business account with a balance of less than \$800, and that probably \$1,000 would be necessary to show a moderate profit.

THE OTHER SIDE OF THE QUESTION

The chain store officials, who impressed me as being unusually fair and broadminded, then spoke informally, telling of the problem from their angle. It was very enlightening, and I must admit that there is much to be said in behalf of the well operated chain store system. Almost every one made the statement that he found no uniformity of charges and no uniformity of requirements on the part of bankers. Bankers themselves do not appear to be acquainted with their own costs of operation, or the conditions under which their accounts would be found to be profitable. There seems to be a great variety of ideas in the minds of the bankers as to their requirements. These cannot be determined by the chain stores themselves, but must be ascertained by the bankers. Some banks appear to make a profit on an account upon which others cannot. In many communities there appear to be too many banks to make banking economical, as the total business is too much divided. Certainly, the customers of these banks should not be called upon either to maintain balances or to pay

such charges as to make all of them profitable. In one community in which several chain stores were doing business, it was decided by the clearing house or banking group that certain balances must be maintained, although the costs of operation in the different banks varied greatly. The chain stores moved their accounts to a neighboring town, as they could not comply with the conditions imposed. Pressure was brought by the bankers in this town, together with some pressure from politics, to force the chain store organizations to come to time. Tactics of this kind do not promote friendliness or cooperation.

CASHING OF CHECKS

One of the very large problems of chain stores is the cashing of checks, or the accepting of checks in payment for purchases. One grocery company reported that its average sale over a period amounted to \$.72, while the average check given to it was \$12. To a certain extent it was thought that the chain store should not be penalized too severely for this apparent service to the community. There are, of course, two sides to the check cashing question. One is that just mentioned, but the other is the increase in purchases due to the convenience of the check and the increased safety of the funds while in the hands of the store.

One of the companies felt that the criticism contained in the questionnaire pertained not so much to itself as to the newer organizations, since no complaints had been received recently from the bankers, probably because their relationships had been settled two or three years before. At that time the company obtained the

figures of its banks throughout the country and settled each case individually. Bankers who make the broad assertion that chain store accounts as a whole are unprofitable are not well informed as to their own business. The city accounts of these companies, it was stated by the chain store operators and admitted by the bankers, are conducted in such a manner as to prove the fairest intentions. In many instances free balances have been left which are large enough to offset the activity of the accounts. The bankers themselves have encouraged the use of checks more and more cordially during the past few years. Large companies are desirous of paying their employees with checks, on account of the safety of this method as compared with handling cash. The cashing of these checks has been solicited by a number of companies, and certainly represents, said the chain store operator, an accommodation to the banks on a busy day when it would be almost impossible to handle so many checks expeditiously.

Still another official stated that his company made a practice of correcting every condition brought to his attention by the banks, as he hoped to make his business with them satisfactory in every respect. He stated that less than 13% of the receipts of his stores is in the form of checks, and in some communities practically no checks are received. In his company the average sale was said to be \$.77, and the profit for the same period 2½%; so that a \$.03 charge on checks cashed would eat up all of the profit and be prohibitive. He felt that a \$2,000 free balance would not cover the cost of most of his accounts, and stated further that

his average weekly sales per store were only a little over \$1,000, so that naturally a \$2,000 balance would be a great burden. He felt that banks should make a practice of charging for special services to those who actually used them, and that this charge should not be distributed over the rest of the business of the bank.

BANKERS HAVE AN EDUCATIONAL PROBLEM

Another high official of one of the companies which has stores in almost every town in our territory ventured the opinion that bankers have an educational problem, as well as the operators of the chain store organizations do. He did not feel that a uniform method of conducting his accounts could be maintained, and believed that his company had always been willing to discuss conditions with its banks. He preferred to have such controversies settled by his local managers, as this would improve the understanding and relationship with the banks, and place them on a more solid foundation than if the home office handled all the negotiations. He stated further that it is of primary importance that banks should be urged to analyze their costs carefully in order to talk intelligently and forcibly regarding the profit or loss on the accounts.

OPERATING COSTS

It was maintained by another that his experience with banks indicated that their operating costs varied tremendously throughout the country, and that the replies to the questionnaires confirmed his belief that many banks did not analyze their business

carefully. He said that one country bank had requested an increase in the balance of his account with it. In the letter the bank admitted that it had not analyzed its costs, but was basing its request for additional funds on figures it had obtained from a nearby city bank.

If services are to be charged for, we must know what they cost. We cannot assume that the costs arrived at by other institutions apply to our own. Power companies and other public utilities know the cost of their services before setting rates. Even the tailor knows the exact amount of labor and material involved, and the necessary profit, before naming the price of a suit of clothes. The automobile manufacturer cannot set the price of his car until he knows what it has cost him to make it. Neither can we tell a corporation what our services are worth until we know and can show by detailed costs that we have done a little figuring ourselves. If every one of you would take the trouble to ascertain even in a superficial way the cost of your services, I am sure that accuracy would soon be the logical result. If you do not work out your own costs, I am afraid that you will, one of these days, be very much embarrassed by some treasurer to whom you have appealed on the basis of expense, for a more adequate balance.

The time of various employees, including the officers, should be allocated to the respective services; the proportion of taxes, light, heat, rent, stationery, and so forth, should also be allocated to these same services. When this is done, a reasonable count of the different operations, items, or services should be made for the period of time under considera-

tion. The cost then divided by the number above will give you a fair idea of the unit expense.

We have visited several banks during recent months and have made an effort to study the problem with which they are confronted. In our opinion the costs of the various operations can be figured with reasonable accuracy and with a very small amount of effort. The costs that apply today will, naturally, not be accurate costs for next month's operations, as they are entirely dependent upon volume of business. It is advisable, therefore, to refigure these unit costs, possibly once a year or oftener; but when you have once arrived at a figure for the cost of a check on one of your own customer's accounts at, say, from \$.03 to \$.05, or a clearings item from \$.02 to \$.04, this figure might be used for a considerable period of time until some radical change of conditions takes place. So much for unit costs.

The determination of the activity and float of your accounts is of primary importance in persuading your customers to maintain adequate balances. At the end of the month the number of checks and deposits on the questionable accounts should be taken from the deposit slips and the check count entered on the analysis sheets; thus you have all the information necessary to ascertain the status of each account. Then if you know the cost of your services you need not hesitate to discuss your problem with any fair-minded customer. In Denver we have no set rule of analysis or charges, but most of the banks are watching their accounts closely. We figure \$.02 per item for deposits or withdrawals; from \$.06 to \$.10 per \$100 a month for overhead, and a

reserve against commercial balances of 15%.

EARNING POWER OF AN ACCOUNT

The earning power of your accounts is the average return on all of your deposits. This figure can be drawn off monthly or quarterly. From this average rate should be deducted the loan expense and unallocated overhead cost. By "unallocated" cost, I mean the cost of your bank's operation, less the actual expense of handling the items. The resulting figure is the net rate of return on your collected balances.

We prefer to show the net earning power of our accounts to our customers rather than to confuse their minds by the additional deduction of overhead as a separate item. Of course, interest paid and special charges against the accounts for check books, deposit collections, and so forth, are expense items in addition to the per-item cost.

I have shown herewith a deposit ticket indicating the simple method of keeping track of float and the number of items by the tellers or the analysis department; also a work card for entering these figures daily. We use the analysis sheet shown, which we have found is simple, understandable, and practical. Our sheets contain spaces for twenty-four months' analysis, but we also use them in communicating with our customers whose accounts need an increase in balances.

CUSTOMER WILLING TO MAKE UP DEFICIENCIES

We took up the question of losses very timidly at first, but have found

that the average customer, whether independent or chain store, does not want his business handled at a loss by his bank. I refer to the customer who has been repeatedly solicited and can go to any institution in the city. When a fair statement of detailed facts is set before him, he is anxious and willing to make up the deficiency in balance or to pay the charge necessary to make his account profitable. A number of the largest organizations in town have increased their balances and are graciously accepting a per-item charge to make their business satisfactory. One large eastern corporation, with stores in most of your towns, was approached with reference to a charge to be made on the transfer of funds. His answer was, "No; we will increase our balance, and pay you \$.015 an item, which ought to make our account satisfactory." Another eastern concern wrote that it was installing a new system of accounting and would pull down its balance to \$3,000; it requested a draft from us once a week. We thanked the corporation for continuing to do business with us and forwarded it an analysis of its account, showing that a considerably larger balance was required to cover our expense and a moderate profit. A letter came back in the return mail containing the firm's version of the analysis and telling us that it would be very pleased to have us draw the draft down to \$6,000 basic balance instead of \$3,000. Another company, upon being shown figures, readily agreed to credit our account at one of the New York banks with New York funds, thus eliminating a large item of float. Still another replenished our account in Denver with funds from one of its collecting depositaries,

putting its business on an eminently satisfactory basis.

Most of our accounts with heavy activity are sorting their deposits according to the banks on which the checks are drawn, in which instance each of these deposits is charged as

one item. In the brief period in which we have been working on this problem, we have obtained many thousands of dollars of increased deposits, and have received a very tidy amount in service charges from accounts that would be received with

Deposit Ticket		
THE BLANK NATIONAL BANK		
Account of <i>John Jones</i>		
<i>Jan. 6, 1930</i>		
	Dollars	Cents
Currency	<i>100</i>	
Gold		
Silver	<i>20</i>	<i>25</i>
Total Cash \$	<i>120</i>	<i>25</i>
Checks		
(List Separately)		
<i>(14)</i> <i>27-2</i>	<i>10</i>	
<i>32-1</i>	<i>32</i>	<i>15</i>
<i>23-7</i>	<i>64</i>	<i>19</i>
<i>5</i>	<i>129</i>	<i>20</i>
<i>(6)</i> <i>C</i>	<i>43</i>	<i>75</i>
<i>99-37</i>	<i>209</i>	<i>62</i>
	<i>609</i>	<i>16</i>

Deposit Ticket showing marking

one day
float

Number of
Items

ACCOUNT ANALYSIS OF

John Jones

Average Daily Bal. _____
 Less - Float _____
 Net Balance _____
 Less % Reserve _____
 Net Available Bal. _____
 Net Earning Power _____
 Interest on Transfers _____

Gross Income _____
 Interest Paid _____
 Items @ ea. _____

Total Expense _____
 Gross Income _____
 Net Profit or Loss _____
 Criterion _____
 Number of Items _____

Analysis sheet showing method of analysis

January		February	
Float	Items	Float	Items
1			
2			
3			
4			
5			
6	<i>1</i>	<i>4</i>	<i>6</i>
7			
8			
9			
10			
11			
12			
13			
14			
15			
16			
17			
18			
19			
20			
21			
22			
23			
24			
25			
26			
27			
28			
29			
30			
31			
Total			
Avg			

Specimen of Work Card

open arms in any other bank in Denver. Why should you not feel free to discuss your compensation with any of your accounts, in full confidence that a request based on facts will receive attention?

EFFORTS OF CHAIN STORES FOR BETTER RELATIONSHIP

Since the conference which I have just mentioned, one of the largest of the chains, about which the greatest number of complaints have been registered, has instructed each one of its managers to discuss its relationships with the thousands of local bankers who are rendering it services. Another organization made a request, which could not be granted, to be supplied with the names of all dissatisfied banks. In lieu of this list it has, therefore, written to every bank with which it is doing business. The treasurer of one of our largest utilities is making an intensive study of his banking relationships, to the end that his banks may make a fair profit from the business which he gives them.

It might be interesting to know that these national organizations are very sensitive about their community obligations and relationships. Large sums of money are to be expended for the purpose of creating good will in the various communities. The companies are endeavoring to arrive at a fair amount of their profits for donation to local charities. Store managers are urged to do their part in the community in chambers of commerce and service clubs. One operator stated that over 500 out of 1,500 managers had been presidents of community organizations during the past two or three years.

I wonder whether this does not indicate that these organizations realize their obligations to the communities in which they operate? Should they not be encouraged to take a greater part in our affairs, to the end that a better understanding and a better spirit of "live and let live" might prevail?

In closing, let me state that there exists a real necessity for more education both among the bankers and among the type of customer under consideration. I feel that reasonable demands based on actual figures which demonstrate efficiency will receive close attention and adjustment. If our brother bankers have gone to these organizations with all kinds of complaints founded on other fellows' figures and guesswork, it is little wonder that they have been disappointed with the results. Therefore, let us resolve to profit by the errors of the past: let us first know what we are talking about, and then present our claims to these national organizations, as well as to every other type of customer that is using the bank as a free service station. I do not believe that we shall be disappointed with the results, if our requests are founded upon facts, economy, and fairness.

SUGGESTED ACCOUNT ANALYSIS SYSTEM

To obtain "float" on deposits, the teller will mark transit number on deposit ticket opposite each check listed. This describes each item. Next, he will multiply amounts of items by number of days required to collect (using Federal Reserve schedule as basis). This gives total float for *one day*, which is then posted to the work card. At end of

month total float is added, and this sum is divided by number of days to arrive at average daily float. Number of items is also posted on work card at time of posting float.

Discussion

EDWARD F. LE BRETON (Hibernia Bank & Trust Company, New Orleans): I want briefly to cite a very unpleasant experience that I had in New Orleans with one of the very largest chain store operators. There are nine branches of our bank, and many of the stores in this chain have made it a common practice to get from our branch banks change in amounts ranging from \$10 to \$50, in half dollars, quarters, nickels, copper pennies, and so forth. We had solicited the account and felt that if we were giving the store that type of service we were entitled to have it keep some money with us, but we didn't get anywhere at all with the solicitation. I instructed our branch managers to refuse to give the stores any change. A while afterward I had a telephone message from one of the local officials. He was highly indignant and wanted to know whether it was a fact that such instructions had been given to our branch managers.

I asked him if he would please tell me why we should furnish him change when he was not a depositor of our bank. He attempted to tell me that that is what banks are there for—to give change to people. I told him that we just weren't going to do it, that was all.

He said, "Well, all right; we are glad to know it. We won't bother you any more."

I said, "My friend, I will make a

bargain with you. Don't bother us any more and I promise you we will never solicit your account again."

He said, "All right, we will go further than that. We will instruct our employees not to do business with your bank."

I said, "That's fine, but keep your store managers away from trying to get change from us."

The result has been that store managers would get a boy in the neighborhood to get \$10 or \$15 or \$20 in change from the bank, and he would say it was for the drug store or a department store or some other place. They have tried every subterfuge. It really has become a sort of game between us, to see whether or not we can catch them trying to get change from us through various tricks. That is the experience we have had. I must say that a good many other branch stores and chain stores have been perfectly fair, but this company has been terrible.

I had another experience which also amused me considerably. A certain company, national in its scope, opened up one of its stores in our main shopping district. We had solicited the account in New York. A young fellow walked in and said, "My treasurer says that you are to have the first chance at this account. I have come to talk to you about it."

I said, "We are delighted."

He said, "I want to know up to what hour in the day I can make my deposit."

I said, "Up to three o'clock. That is the clearing house rule in New Orleans."

"Well, that won't do. I have to make my deposit later than that."

I said, "I am sorry. I don't see how it can possibly be managed,

since we close at that hour and no exceptions can be made."

He said, "I don't care how you receive the deposit. I will leave it with the watchman, but I have to get rid of the money." He then very naively explained that the company did not provide any safes, and that he had no place to leave the money over night.

These two instances are probably extreme, but I do think they are indicative that some of the chain stores are not giving due consideration to the right of the banker to make a fair profit from handling their business.

OSCAR DYKES (Hamilton National Bank, Chattanooga): With reference to Mr. Le Breton's statement about late deposits, I should like to say that we have found a solution to that problem in the form of the night depository, which most of you probably have, too. We found it to be very satisfactory. One of our largest chain stores in Chattanooga has about sixty stores, and they use that plan of deposit altogether. This chain store is one of our most profitable accounts. This experience may be a bit unusual, but this particular chain store is unusual. Our experience with chain stores in Chattanooga has been very satisfactory.

Of course, we all solicit their accounts, but clearing house banks have come together and decided on a plan on which to work. When these stores come into Chattanooga we tell them what we will do and what we expect them to do. We have found that they comply with our wishes in almost every instance.

Then, too, it was my pleasure not long ago to call on some of the larger

concerns, and almost invariably we found that it was their wish that their accounts with us be profitable. Our charge for the night depository is \$1 a year, but prices vary. It is not a paying proposition to us, except in service.

MR. LE BRETON: Have you made an analysis of that account with the sixty stores, on a per-item charge?

MR. DYKES: This account is very unusual, and I should not care to go into details, but we know for a fact that it is one of the most profitable accounts we have. It is not a national chain store, however.

MR. LE BRETON: Is it local?

MR. DYKES: It is interstate, operating in three or four states.

HARRY R. GOSLING (Oneida National Bank & Trust Company, Utica, New York): A large account we have had for some time has turned out now to be very satisfactory. We have no night depository, but we do receive the deposit from this firm on Saturdays toward evening, after the banks close, because Saturday is a big day. On certain occasions we have received deposits at five or six o'clock when the next day was to be a holiday.

In the matter of the analysis of the chain store accounts with us, they are analyzed on the same basis as the rest of our accounts. I am wondering whether it is the experience of the men here that deposits are brought in in packages for each store. That is our experience. We have the accounts of a great many stores in central New York. That makes a lot of teller work. We have counted the number of transactions for our monthly analysis.

In the matter of checks being cashed by the stores, we have had

quite a bit of correspondence with one company in regard to the inclusion of these checks in its deposits, which increases the activity. The store has instructed its managers not to cash any more checks in our locality, so that is cutting down the activity. I took up the matter of an increased balance with one of the vice presidents of the company. We had a most helpful conference. The situation is now very satisfactory, and the store is keeping a dormant balance with us.

NEWTON NORTH (First National Bank, Lake Charles, Louisiana): On one chain store account we figured out the balance that would be necessary to make the account carry itself. We took it up with the treasurer of that company and sent him a copy of the analysis. We suggested that the balance be increased to one that would justify that cost, or that in lieu thereof we substitute a service charge. He immediately answered that letter by authorizing us to charge his account not only with the cost of the account, but also with a reasonable profit for the bank.

THE CHAIRMAN: An officer in one of the banks in a city of more than 100,000 population told me that two of the chain stores had come into his town. The banks, naturally, were anxious to get the accounts. The chain stores wanted this: to secure interest, to have the bank absorb the float, to get the bank to send to the office for the deposits, and, in receiving the statement at the end of the month, to have checks listed numerically, so that the auditor could do his work more easily. That is an absolutely true statement.

HERBERT GEYER (Union Industrial Bank, Flint, Michigan): Sev-

eral years ago we had an experience similar to that of the gentleman from New Orleans, in refusing change to the managers of different stores. We not only got better accounts, but a far better understanding with the officials of the chain stores, with less expense and less accommodation on the part of the bank, and more satisfaction to the managers of the stores.

RILEY C. TEEL (Liberty National Bank, Waco, Texas): We lost an account because we did not have a night depository. The company wanted to make the deposit every night between nine and ten o'clock. It eventually moved to a neighboring bank that had a night depository. We have lost several accounts for that reason, and feel that we shall be obliged to install a night depository.

MR. GOSLING: The chain stores are here to stay, and I am in favor of putting in a night depository for their convenience.

MR. LE BRETON: By agreement, the New Orleans banks, through the New Orleans Clearing House, have agreed not to put in night depositories. I think this is very wise. Where it is possible for the clearing house associations to come to such an agreement, I certainly recommend it. What are you doing, after all? Merely increasing your cost of doing business to accommodate comparatively few depositors. I think it would cost you \$7,500 to install the best kind of night depository, if I remember the figures correctly. The interest on that investment and that outlay of money to take care of the comparatively few accounts which want to deposit at night should not be a problem of the

bank. It should be the merchant's own problem, for him to solve, and not a burden on the bank. It is those things which the banks have been doing for the last twenty-five years which have now got the banks into the position where they have increased their cost of doing business so much that they have to reverse their method and start charging for a lot of things that they were previously doing for nothing.

MR. MITCHELL: I should like to subscribe to what Mr. Le Breton has said about the night depository. We have one or two of them in Denver, and probably eighteen or twenty accounts out of our 9,000 or 10,000 commercials are using our night depositories. We tried advertising the thing to encourage business to come our way, but we got no particular results. If I were doing the job over again, I think I should follow just what the New Orleans Clearing House is doing.

I was rather enthusiastic about the night depository at first. You can build up a pretty picture, but the customer does not appreciate it any more than he does half the other free services you are giving. He thinks they are worth about what you are charging for them. I should suggest that you get your depositors together and agree on a rental fee before you spend money on installing night depositories.

One word more. You are all interested in making expenses on this trip for your banks. A few years ago I attended a meeting of the Reserve City Bankers. Somebody at that meeting suggested the deduction of the reserves kept with the Federal Reserve before payment of interest. We came back here to Denver, and

our clearing house got together and deducted what in Denver is a 10% reserve. This has been going for three years. We are not paying interest on the 10% of our deposits that normally would have drawn interest, and we are saving a very substantial amount of money.

We have run into this situation: Certain chain store people say we are the only city in the country that has deducted the 10%. We know it is not true, but they say we are. We pay no attention to them; there are other cities, and a number of them, that are doing this, and it is perfectly fair. The reserve is a non-earning asset. You can't get anything out of it. There is no reason why you should pay interest on it. If you will go back home and encourage your own group of banks to discontinue the payment of interest on the reserve of the Federal Reserve bank, I think you will make the expenses that have been paid for this trip.

E. V. KRICK (American Trust Company, San Francisco): I should like to add a little information to Mr. Le Breton's remarks regarding the night depository. One of the largest cities on the Coast had this question up before the clearing house and agreed not to install the depositories. I know that many of the banks in San Francisco have discussed the question. We have no well organized cooperation between the banks and the clearing house, however.

In our own case, we investigated the proposition very thoroughly on two occasions. We went around in several of our neighborhoods and endeavored to solicit accounts on the proviso that if we installed the night depository the customer would be

willing to pay a fair rental. We were not able, however, to get enough customers to sign up on that basis to pay a return on the investment.

MR. DYKES: I made the statement that the night depository was not a paying proposition. What I meant was that it did not show a large profit. We collect each year for rentals about 10% of the cost of our night depository. But, after all, you are accommodating your customers and giving them a service they need. Isn't it efficiency to have one safe or depository in one bank or one in each of your biggest banks where all these customers can put their deposits, and keep each one from having to pay for protection and insurance, safes, and everything else? I still believe that the night depository is the solution.

MR. MITCHELL: We haven't found the fellow willing to pay the bill. Outside of that, we agree.

MR. LE BRETON: You have the most unusual situation, Mr. Dykes, in that you have been able to collect rental.

MR. DYKES: We send a statement annually.

MR. LE BRETON: It is the first instance I have heard.

MR. RING: I should like to ask on what basis that rental is figured.

MR. DYKES: It is merely a flat charge of \$5 per year. Our clearing house banks agreed that this would be a fair rental and compen-

sate us for our effort. It is possible, Mr. Le Breton, that your night depository would cost that much, but ours did not. We have two in our head office and one in our branch. The one in our head office cost only about \$1,500.

A. C. BURCHETT (Bank of Commerce and Trust Company, Memphis, Tennessee): I agree with Mr. Mitchell. We have built a new bank in the City of Memphis. We are very proud of it. We didn't want to leave anything out, so we put in a night depository, but we have never been able to persuade our depositors to pay us. There is a certain risk in it, regardless of all the care you exercise. I would give serious consideration to it if I were going over it again.

MR. GEYER: We are the only bank in the city that has not a night depository. We have the greatest number of branches, at the most convenient locations. Other banks have their night depositories, and they did persuade several chain store accounts to use the night depositories. However, it did not work out very satisfactorily on account of their unfavorable locations. The chain stores, instead of using the night depositories of the other banks, use the armored car service to pick up their deposits. They pay all the expense of collection and insurance, and we are getting the deposits just as we would any other deposits.

Responsibility of Directors

By WILLIAM H. LINDSAY

AUDITOR OF THE PROVIDENT TRUST COMPANY OF PHILADELPHIA,
PHILADELPHIA, PENNSYLVANIA

Address before the Denver Departmental Conference

Mr. Lindsay places a great deal of the responsibility for operating a bank safely and economically upon the shoulders of the directors. The first duty of the directors is "to see to it that their institution is kept in such condition that the depositors, trust clients, and other customers suffer no loss, and that the services rendered are the best possible, commensurate with the compensation received."

The board of directors should formulate policies rather than emphasize details.

Since the directors are responsible for safe and economical operation, it is necessary that they have submitted to them reports that are concise and that convey a true picture of the operations and condition of the bank. There should be, periodically, in connection with this information, a directors' examination of the assets.

In great measure, the responsibilities of the directors can be discharged completely only if they choose an entirely competent operating officer.

I IMAGINE that the reason a subject such as Responsibility of Directors was chosen for this conference on Bank Administration was for the purpose of showing what responsibilities our boards assumed when they took office, thereby enabling us to present more intelligently to them such data as will permit the directors to picture the operations of our institutions accurately. This idea is the only reason I have for attempting to put the following thoughts before you, for I am not a director of a bank or a trust company, and at present I can see no likelihood of my ever acting in that capacity. I have, however, prepared many reports for the board, and I get rather a fine thrill trying to clarify and improve the regular routine reports submitted at each meeting.

I am associated with the Provident Trust Company of Philadelphia, which was organized in 1922 to acquire and carry on the deposit and trust business of the Provident Life and Trust Company of Philadelphia, instituted in 1865 by a group of Philadelphia Friends (Quakers) to insure lives and to do a general trust company business. This latter organization now operates only as a mutual life insurance company.

Our company is unusually blessed by having directors who are thoroughly familiar with their duties and responsibilities, and before I was asked to prepare this paper, I had given little thought to what the directors' responsibilities were. I have, however, been trying for years to learn what reports are necessary to enable the board to picture clearly all of

our transactions, condition, and earnings.

DIRECTORS MUST SEE THAT BEST POSSIBLE SERVICES ARE RENDERED

It seems to me the greatest responsibility of directors is to see to it that their institution is kept in such condition that the depositors, trust clients, and other customers suffer no loss, and that the services rendered are the best possible, commensurate with the compensation received. The directors owe it to the community that their institution function properly through times of business depression as well as in prosperity. They should realize that their moral duty is as real as their legal duty. Leaving the interpretation of moral duty to each individual director, I often wonder how many of them have had interest enough in their jobs to read the statutes under which their institution operates. Courts have often held that directors stand in a fiduciary capacity to the corporation and the stockholders, and the powers incident thereto have much more latitude and are much less limited than those of the ordinary trustee appointed by deed, will, or decree of court. This wider freedom imposes stricter responsibility to perform every duty with the utmost care.

Then there is the responsibility to the stockholder, who puts up the capital and elects the directors to direct the operations of the institution. The directors should see to it that the bank or trust company is run efficiently and economically (but never cheaply) in order that there may be a margin between the earnings and the expenses to compensate the stockholders.

SELECTION OF CHIEF OPERATING OFFICER

The selection of the chief operating officer of a financial enterprise is another extremely important responsibility of the directors and one which they should fulfil only after careful consideration. The directors should elect the president rather than have the president elect the directors, as so often happens.

It is easy for some men to become dominating instead of directing directors, by requiring every detail to be acted upon by the board. Others are mere rubber stamps and are often dominated by the operating head of the institution. A happy mean between these two types should be the aim of every man who has accepted the honor of becoming a bank director. The board room should be the place where the policies of the institution are formulated rather than the place where details are acted upon.

Another duty of the directors is to arrange to have submitted to them reports that are concise, and that convey a true picture of the operations and condition of the bank, with enough past figures to make possible a reasonable comparison.

EMPLOYEES MUST BE KEPT CONTENT

A financial institution can be run satisfactorily only if the rank and file of the employees are contented, even though they are not satisfied. One of the responsibilities of the board, therefore, would seem to me to be to pay the employees as generously as is consistent with the business conducted, and, wherever possible, to fill the high-

er positions from within the bank. With one exception, our officers and department heads at the Provident have been elected or appointed from among the directors and employees, and it does tend to encourage the employees to take an interest in their work and to study on the outside to prepare themselves for added responsibilities.

Regular attendance at board and committee meetings is imperative. Any man who accepts the privilege of serving on the board of directors of a bank should see to it that his other engagements do not interfere with his being in his place promptly for meetings, and he has a right to expect punctuality and regular attendance from his colleagues.

At least once each year the board of directors should make a physical examination of the assets of their institution and those held in a fiduciary capacity. I have, at times, heard rather uncomplimentary remarks concerning directors' audits; nevertheless, I see no reason why a directors' examination should not be as efficiently conducted as any audit made by a public accountant. I am of the opinion that the examination made by the directors of the Provident compares very favorably with that made by our public accountants, and we employ accountants whose reputation is nationwide.

DIRECTORS' EXAMINATION OF ASSETS

It is a decided advantage, if not an actual duty, for the directors to become acquainted with the employees who handle the collateral held for loans, bonds, stocks, and other more or less negotiable assets, as well as

with the method of recording these items and the orderliness of the files. This should be one of the purposes of the directors' examination, but whenever there is an audit of all of the assets there is usually so much confusion and excitement among both the examiners and those who are being examined that this purpose is eclipsed by the desire to get through at any cost. In order to overcome this at the Provident, a small committee of directors, say three or four, is appointed by the chairman of the audit committee to serve one month as an "audit committee for the month." As our board is small, this enables each director to serve three or four times each year. It is the duty of this committee to visit the offices of the company during the month and make a test examination of the negotiable assets of the company and the trust department and to submit a written report of the assets examined, with any comment regarding the assets, methods, or personnel, to the board. We have found that the examinations made by this small committee are well worth the trouble and expense they entail, because they have a tendency to keep the personnel handling this group of assets on their toes, for the men never know what is going to be examined; and at the same time, it permits the directors to make observations that would not otherwise be made.

I feel that in institutions where an audit department has been organized, this department should be responsible to the chairman of the audit committee of the board or to the chairman of a similar committee who is not an operating officer, and that the auditor should make monthly written reports to the board of the

work done by this department, with such comments concerning the manner in which the work of the institution is being done as seem fitting. When such a plan is adopted, I believe that the audit department should function purely to audit the assets and accounts and not to make entries or to have custody of any assets or vouchers. The audit department should, however, have joint control, with one of the operating departments, of all items where joint control is advisable. At any cost, we should beware of setting up a secret police system, or attempting to convey the impression that this department is composed of a set of watch dogs. It should act for the institution more as the governor acts for a steam engine, to keep the machine running smoothly. An auditor should attempt by proper suggestion to keep the methods up to date as well as to prove the correctness of the work. If he is responsible directly to the board, he has a marked advantage over one who reports to an operating officer, because he has the right of appeal to the directors; and while this should be reserved for unusual circumstances, I know from my personal experience that it does have considerable weight.

REPORTS SHOULD NOT BE MADE ORALLY

To me there are few things so tiring as attending a meeting where reports are made orally, especially reports filled with statistics. It is, therefore, to my mind, much better in preparing reports for the board to have a copy made for each director and have it placed in the board room a reasonable time before each meeting. The preparation of these reports

should be made a matter of daily routine, so that it becomes a burden to no one.

In writing the report of the transactions to be submitted to the board, care should be taken in arranging the items under any grouping, so that not only the group stands out, but that each item is easily read and distinguished from other items. This report should contain:

1. Company

A condensed statement of the present condition and that at the time of the last board meeting

A condensed statement of the earnings for the period and what they were by the last report

Loans made since last meeting, showing the amount loaned, the rate of interest, and total amount due by each borrower; a note concerning the line of credit, or the collateral deposited, and the market value thereof

Letters of credit guaranteed—through whom and how secured

Changes in securities and mortgages owned by the company in its corporate capacity

Amounts borrowed and repaid Federal Reserve bank or correspondent, and present balance due

Total of deposit accounts opened and close since last meeting

Present deposits, compared with amount at time of making last report

Time loans maturing before next meeting

Changes in stockholders

2. Trust Department

Statement showing summary of

changes since last report, and present balance itemized to show amount invested and cash in bank for both corporate and individual trusts

Itemized statement of all purchases made for trust estates and agency accounts

Itemized statement of all items received in kind for trust estates and agency accounts

Itemized statement of all items sold for trust estates and agency accounts, showing amounts gained or lost

Statement of applications for mortgages, giving details as to location, valuation of property, rate of interest, time, amount of application, and account.

After the closing of an accounting period, a report should be submitted showing an analysis of the revenue accounts, giving totals for year to date, together with a comparison for last year, and the total of the appreciation or depreciation of the company's investments over the book value.

The reports before mentioned are the usual routine reports, which are supplemented from time to time as occasion requires.

It may be that a feeling will arise in some institutions that it is unnecessary to make such detailed reports as

I have outlined or as are being at present submitted. Perhaps this is true, but do not lose sight of the fact that it is far better to submit too full a report than one that is too brief, for it is only by understanding the situation clearly that the officers can discharge their full responsibility to their directors.

DIRECTORS' RESPONSIBILITY FOR SAFE AND ECONOMICAL OPERATION OF THE INSTITUTION

To sum up: The major responsibility of the directors is to see to it that their institution is operated safely. It should be operated economically to provide earnings to compensate the stockholders. In great measure these responsibilities can be discharged only if a competent operating officer is chosen. It should be the aim of the directors to direct rather than to dominate, and to be prompt and regular in the attendance at meetings. They should institute a definite policy to insure the contentment of the personnel. There should be at least one examination each year of all the assets of the company and the trust department by the directors, and partial ones more frequently by a small committee of the board. Joint control of all negotiable assets should be established and maintained.

Personnel and Accounting Safeguards

By A. R. LEMM

ASSISTANT MANAGER OF THE NINTH WARD BRANCH, FIRST WISCONSIN NATIONAL BANK, MILWAUKEE, WISCONSIN

Address before the Denver Departmental Conference

Most bank executives now recognize the fact that dependability and efficiency on the part of their employees are controlling factors in the extent of their profits. For this reason, much attention is given, and even more attention should be given, to the careful selection of employees, to their placement, to the incentives put before them, and to the practical training which is given to the personnel. For this last activity, only unusually competent instructors should be chosen.

Since so many accounting safeguards are for the purpose of checking up or preventing fraud, inaccuracy, and error on the part of the personnel, it is entirely appropriate that personnel and accounting safeguards should be treated in the same address.

The system of accounting that provides for the continuous audit as the transactions actually take place, is the only real safeguard for any institution. Irregularities created through dishonesty can best be avoided by continual internal check.

Mr. Lemm mentions specifically the accounting safeguards which have been installed in the several bank departments.

YOU probably wonder, as did I, why two such apparently independent subjects should be combined in one discussion. The fact, however, is that they are very closely related. This being the Bank Administration Conference, I will not delve into any intricate phases of accounting, as they will be discussed at length in the Audits and Accounting Conference. Only such accounting safeguards as will directly affect the personnel administration and control in a bank will be discussed.

In recent years bank executives have been focusing considerable attention on the building up of the intangible assets of their banks; in

other words, their personnel. Most of them recognize the fact that the dependability and efficiency of the employees are controlling factors upon which the extent of profits depends. I am addressing bankers. Is there any doubt in your mind that it requires a skilled, well trained, well educated personnel to operate a bank successfully? Such a personnel is not developed over night but only through years of experience, hard work, and consistent effort, together with the mastering of highly specialized courses in banking and kindred subjects. Nor can this type of personnel be acquired otherwise, as the demand already exceeds the supply. Executives, there-

fore, are very much concerned with the selection, training, developing, and holding of a desirable personnel. This presents us with our problem. How can banks safeguard themselves against incapable and undesirable employees, against lack of efficiency, and against excessive turnover, all of which enhance the operating cost of any institution?

There are many personnel safeguards; in fact, all constructive personnel work may be considered as a safeguard against the entire category of evils encountered in administration, such as inefficiency, temptation of employees, discontent, and excessive turnover. The safeguards I here propose are fundamental and applicable to any office or institution. They are careful selection and placement, practical training and education, proper incentives to develop in employees the will to do their best, and knowledge of employees' activities after banking hours.

CENTRALIZATION UNDER A PERSONNEL OFFICIAL

To institute effectively any policies or safeguards, there is one fundamental factor to be considered in the personnel work of any office, regardless of its size. I am sure that all personnel men will agree with me that the control of all personnel work should be centralized under the direction of an official who has authority equal to that of any other executive in charge of any of the other major operations, and who is directly subordinate only to the chief executive. Personnel administration is a major function and benefits by centralized and specialized supervision in the same manner that other functions benefit. It is only

through centralized control that uniform policies in the various phases of the work can be instituted as safeguards. However, all work in this department must be done in perfect harmony and cooperation with the various departments affected.

SELECTION OF EMPLOYEES

"Guard well the outer gate and let only those enter that are worthy and well qualified." This phrase, with which many of you are familiar, is a bit of wisdom handed down to us from the ancients, but how applicable it is to personnel work in a bank! We cannot overemphasize employee selection; it is of fundamental importance. The very nature of our work and our relation to the public demand the highest type of employee obtainable. The extent of precaution exercised in selection should be limited only by the ratio of supply to demand. The responsibility of selection usually rests with the interviewer. He therefore should have a thorough knowledge of the nature and requirements of the work for which he interviews the applicant. He should know what qualifications have proved most satisfactory in other or former employees. This information should be obtained through personal contact with the job, through observation of the work as carried on by others, or through direct job analysis. All qualifications or characteristics of the applicants should be thoroughly investigated and interpreted in terms of positive knowledge of the requirements. Character and capacity for growth are essential qualifications in all applicants; to these may be added as a requisite in most cases, personality. Other qualifications are important in

proportion to the possibility of applying them to the needs of the business, either present or future.

PLACEMENT OF EMPLOYEES

Care and good judgment should not rest with selection but should be applied with equal sincerity in the problems of placement. Capability, interest, and adaptability should govern all decisions. The things that we like to do, that we are best qualified to do, are usually done with the greatest efficiency. It is estimated that over fifty per cent of office personnel is misplaced. If this be true it only adds more seriously to our problem. Make an inventory of your office, and you will probably find contact men struggling with the intricate detail of an auditing department, accountants hopelessly floundering about in the attempt to dispense personal service, stenographers laboriously pounding away on a bookkeeping machine, and commercial artists counting currency. Many of them are just holding their own; maybe in your eyes they are failures; in reality they are misplacements. Many employees are not of the versatile type; their latent talents are of a highly specialized nature and should be given an opportunity for expression along definite lines in order to secure the greatest value both from their own efforts and from the investment in salary by the employer.

PRACTICAL TRAINING UNDER COMPETENT INSTRUCTORS

To develop the highest degree of efficiency in any office, a program of practical training under competent instructors should be instituted. This training should be done in connection

with the actual performance of the daily routine. First of all, however, in every employee there should be created a mental picture of his job, its relative importance, and its relationship to the various other activities in the office. This will often prevent interdepartmental friction, and absolute harmony is the strength of all institutions. Regardless of the degree of intelligence of your employee, his ability to grasp a maze of detail and execute it in proper sequence, he should not be placed in any new environment without proper instructions; and no duty, when considered in its relationship to the entire program of operation, is of so little importance that it should be executed in any but the most efficient manner possible or known. Proper instruction speeds up operation, not only through systematic execution, but also through the prevention of errors. Exceptional care should be exercised in selecting instructors in the various departments. They must be thoroughly acquainted with the nature of the work and the most efficient method of execution. They must be patient, extraordinary, tolerant, understanding, possess the ability to express themselves clearly, and be consistent at all times. They must manifest unusual interest in their work, abound in enthusiasm, and be the exemplification of loyalty. Such individuals are splendid safeguards in any institution. The cost of practical training is completely submerged in the increased profits made possible through the greater efficiency of a better trained personnel.

The entrance of employees into actual, active business too frequently marks, of necessity, the end of systematic mental and cultural growth. Bankers have helped them to a great

extent to overcome their false ideas by urging systematic study in banking, and by constantly having them visualize the avenues of possibilities opened through the proper application of specialized education. Banks, like all other organizations, depend for expansion and ultimate success, upon the possibility of promoting a percentage of employees to more responsible positions. To qualify for such promotions requires not only years of practical training but also constant improvement and development of the mind through special educational work. The average person is worth only two dollars a day from the ears down. His increased possibilities depend entirely upon the amount of training and cultivation he gives his mental powers. The opportunity for such development is made possible through the many correspondence and night courses offered by our accredited schools and colleges. Bank employees are unusually fortunate in having additional access to the highly specialized courses of the American Institute of Banking. The Institute is without a doubt the greatest personnel safeguard ever instituted in an industry, business, or profession.

PROPER INCENTIVES

Proper incentives, another safeguard, are very effective as a rule. It is the minority employees of an organization that put forth their best efforts without the stimulation of proper incentives. These may be either material, quasi-material, or non-material. Each has its proper use, but of the three you will find that not only employees but executives as well are more responsive to incentives of the material type. After all, this is

a material world and a rather material age that we live in, and incentives of hope, encouragement, and inspiration can best be expressed in a monetary way. Advancement, eventually reflected in terms material, is a mighty powerful incentive in spurring employees on to greater, more efficient, and more profitable endeavor in behalf of their institution. And, on the direct contrary, advancement without the adequate material recompense is one of the most dangerous temptations to which to subject any employee. Every promotion practically places an employee in a new environment. To try to maintain among friends and associates the status created by promotion is but human, and the result is obvious.

ENVIRONMENT OF EMPLOYEES

Being human, we know that we all are subject to temptations of some kind or other, or have been at some time or other. These temptations are usually overcome through proper associations and environment. In the development of our characters and personalities these two factors are of pre-dominating influence. Personnel departments, therefore, should be vitally interested in the associations, recreations, and environments of their employees. A direct check on all their after-hour activities is an absolute impossibility, but much information can be obtained through various sources at the disposal of the department. Before taking drastic measures with an employee, every effort should be made to counteract any destructive influences.

The ease with which an employee submits to temptation is not always due to the pressure of influences from

without, but often to the laxity of systems or proper safeguards within the organization. That is why personnel departments should be interested in accounting safeguards — safeguards that will act as a continuous internal check and will make defalcations, if not impossible, at least extremely difficult.

CONTINUOUS AUDIT

The system of accounting that provides for the continuous audit as the transactions actually take place is the only real safeguard for any institution. There is a possibility that even then fraud, inaccuracy, or error may creep in, but the systems have been so perfected that blunders are usually corrected with little cost and defalcations are nipped in the bud. Where such systems have not been installed, periodical audits and examinations have great value. However, they usually serve as post-mortems only, reviewing the work after the damage is done.

An adequate accounting system provides for executives, finger-tip information of all operations, a complete picture of assets and liabilities, records of all sources of income, both in total and by individual sources, and classification of all expenses incurred to earn this income. Accrual accounting in this connection furnishes the most valuable control. It reveals at all times the true earning position of the bank. Where the income collected does not reach the amount accrued, thorough investigation should immediately be made. By means of accrual, it is possible to budget the income with reasonable exactness; periodical surveys and adjustment are of course necessary to compensate for changes in rates and income-producing

assets. Accrual removes the possibility of overlooking or misappropriating incomes.

Losses through inaccuracy are often greater than losses through dishonesty. The system of continuous audit is an ideal safeguard in this respect. It serves a twofold purpose: first, that of preventing errors; and, second, that of discovering or locating errors where the effect is noted but the error not located. To accomplish this the system need not necessarily be loaded with unnecessary, cumbersome detail so that it becomes a burden unto itself. On the contrary it should be simple enough to insure accuracy and efficiency. Practically all bank routine is performed on schedule time. Rapidity in obtaining proofs is therefore very essential. All records should also be so organized that any one can easily trace all entries to their final recording.

CONTINUOUS INTERNAL CHECK

Irregularities created through dishonesty can best be prevented by the continuous internal check. Effective internal checks are usually accomplished through the division of activities, supplemented by the activities of the auditing department. No person handling any of the bank's assets should be permitted to record, on the permanent records of the bank, transactions involving these assets; and all income and expense should be controlled, through a dual recording system, by the auditing department.

This is not nearly so complicated as it sounds, and at the same time it removes not only the temptation to, but the possibility of, dishonesty as well. I will touch briefly on some of the safeguards installed in banks.

SAFEGUARDS IN EACH DEPARTMENT

In the commercial department: the dual posting system, where one bookkeeper posts the ledger and another the statement (in some banks a third person passes on the checks as to signature and irregularities); detailing tellers to do the latter (a method not so desirable, but possessed of some merits); segregating dormant accounts under separate and additional control; directing all customers' complaints to, and adjusting them through, the auditing department, thus preventing contact between bookkeepers and customers; sending monthly statements with requests to file exceptions promptly.

In the savings departments: mechanical devices that simultaneously record every transaction in the customer's pass book, the bank's record, and an audit control sheet, with totals under absolute control of a person not handling the transaction; daily proofs of old and new balances to certify the correctness of entries; segregation of dormant accounts under additional control; stamping and initialing of all signature cards to avoid substitutions; pivot systems whereby no transaction originates with, and is completed by, the same person.

In the collateral department: recording securities received on triplicate forms, retaining one and forwarding the other two to the auditing department, which, in turn, forwards one copy to the customer; examination made against auditing records, and all receipts checked against auditing records.

In the discount department: the recording of all notes on multiple forms, with a copy for the auditing division

for the accrual of income; the prohibition of entries on permanent records by tellers; the sending of daily reports of due and past due paper to the loaning division.

In the collection department: dual control within the department. For illustration: a draft received for collection by the teller is passed on to a recording division, entries are made, and the draft is returned to the teller, together with a collection letter in duplicate. The teller checks the item and forwards it with one copy, retaining the other. Payments, when received, are routed through the recording division and passed on to the teller. Tracers are sent out by the teller, and answers are routed directly to the recording division.

I could go on indefinitely, as similar and equally effective safeguards are being used in all other departments of the bank, such as bond, coupon, foreign, safekeeping, and exchange. The purpose of all these safeguards is not the detection and correction of evils, primarily, but their prevention. Both the accounting and the personnel safeguards are essential to successful operation, and both are instituted for the mutual benefit of employer and employee. You will usually find that a well trained, well educated, well paid personnel welcomes, reacts most favorably to, and often is directly instrumental in introducing, the most rigid accounting safeguards.

Discussion

THE CHAIRMAN: When you go home, the one way to make yourselves popular with the organizations with which you are associated is to figure out various methods of

economy on their present ways of doing business. The earnings of banks this year are going to be so much less than they were last year that certainly all the economies possible and all the charges that ought to be made for services will be very welcome. If you can pick out sources of waste in your own organization, short cuts in the present method of doing business, which will eliminate a certain amount of labor or a certain amount of your supplies, those things will be the popular things, will be the things that will enable you to increase your salary and improve your position—especially this matter of charges made in other parts of the country for services you have been afraid to put in for some reason or other.

Let me give you one very brief example: One bank in Denver started to put a charge of four cents per check on every check drawn on accounts subject to a service charge. They did it with fear and trembling. They found that they had no particular difficulty with this plan; accordingly, they have gradually built it up so that they allow now one check for every \$10 of deposit. They make the minimum charge fifty cents and charge for all checks over the one for every \$10 of deposit.

A case came up in our bank this morning about this same charge which we have instituted. We have started it just the way these other people did. They have reached the point of charging over 700 or 800 accounts at the present time, and they don't stop at the accounts that average just \$100. They are taking all accounts that draw an unusual number of checks. Some people, you know, believe that their affluence in

the community is indicated by the number of checks they draw.

In the accounts we looked at this morning, the two or three which did not come under our initial installation plan, one account had a \$54 average and drew 100 checks. Another account had a \$90 average and drew 60 or 70 checks. The charges were \$2 or \$3 or \$4 for each account. The point was brought up that none of these accounts had a \$100 average: couldn't they, then, by adding \$10 or \$15 or \$20 to the average balance left in the bank, escape the charge altogether? The answer to that was "no," because we are going to take accounts that run well above \$100 and make them pay for just what they are getting.

The rule here is going into effect without clearing house agreement to charge four cents per check drawn on an account over one check for each \$10 of average balance—a minimum charge of fifty cents. That is a scheme that will get you a lot of money, is perfectly fair, and can be explained to anybody. You may lose a few worthless accounts, but those you have will compensate. That is a little bit aside from one part of Mr. Lemm's paper, but applies to another part of it.

EDWARD F. LE BRETON (Hibernia Bank & Trust Company, New Orleans): I should like to ask Mr. Lemm whether, in the bank or banks he has investigated, there is an age limit or an educational requirement in hiring the personnel.

MR. LEMM: We have an age limit. We do not hire anybody under eighteen years of age, except for the position of page. We do hire them at sixteen, but we do not hire anybody without at least two years

of high school education, and we prefer a high school graduate. In the past year at least 80% of our new employees had a high school education, and a great percentage of them had a college education.

KARL C. BINZ (Continental Illinois Bank & Trust Company, Chicago): You speak of careful selection and proper placement. Have you had any experience with job analysis or salary standardization?

MR. LEMM: We have made a survey of the salary situation throughout the country. We spent probably three months during the past year in making that survey, comparing our standards with standards throughout the country. There is a national survey put out by the Government, also, which gives you very valuable information along that line, and, by carefully dividing your personnel into groups and comparing it as nearly as possible with that survey, you are able to check up on the salary situation. We also write to the various banks in the different sections of the country. However, that is not always satisfactory, because conditions vary in the various sections. We have always found that our salary situation in Milwaukee was very favorable as compared with that in other parts of the country.

MR. BINZ: I was more interested in the job analysis part of it.

MR. LEMM: We have one man in our personnel department who spends his entire time in job analysis, comparing our personnel arrangements with those in other banks.

MR. BINZ: Do you have intelligence tests for new employees?

MR. LEMM: We do not.

THE CHAIRMAN: It is quite possible that some of those here would

like to know a little bit more about the question of job analysis. I wonder whether you would make a few remarks in connection with that matter.

MR. BINZ: I don't think I know enough about job analysis to speak of it. In our bank we seem to be students of the subject: we have given a lot of thought to it. Mr. Lemm mentioned it in his talk. I thought that perhaps his bank had a very systematic scheme of investigation. You know, job analysis may be a small thing, or may be made a very deep, systematic study, so that you can secure a value or grade index figure on each job in the bank and get a pretty good comparison of all the different jobs all through the office.

MR. LEMM: I think it is more or less in the experimental stage in practically all banks.

THE CHAIRMAN: Mr. Lemm, you said something about the intelligence test.

MR. LEMM: We do not require an intelligence test. In our office job analysis is comparatively new.

ALBERT G. KECK (First National Bank, Chicago): You mentioned in your paper the importance of building up an organization. I should like to know how you feel about the practice some banks have of laying off a great many people when their volume of work drops off, as it has done at the present time.

MR. LEMM: In our office we at no time lay off any employees on that ground. I think the benefit, as far as monetary return is concerned, would not be worth while. It takes a certain length of time to train all your employees to know exactly how to carry out your program. It would

be poor policy to put new employees in their places, especially at the present time, when it is a difficult proposition to get the right type of employee (banks not paying the same amount to new employees, probably, that industry does at present). We find it exceptionally difficult to replace our men in a short period of time.

MR. LE BRETON: I might answer Mr. Keck by saying that our experience in New Orleans is that the turnover is much greater than we like to see it, and this very turnover cures a situation such as you mention. In a large organization, if you have a few more employees than you need, just by the natural process of turnover you will get down to the minimum that you can get by with. Hasn't that been your experience?

MR. KECK: Not in the present situation, because, of course, the turnover is negligible now. Jobs are scarce.

MR. LE BRETON: I don't think our turnover has been any smaller since the beginning of this year than it was at the same period last year.

E. V. KRICK (American Trust Company, San Francisco): I might add our experience along this line,

as a branch bank having some 1,600 or 1,700 employees. We meet the situation there by immediately transferring those people who are not needed in the various departments to what we call a special "B" payroll. That is kept under the supervision of the personnel department. The people are assigned to some work in the bank, whether they are directly needed or not. Not always does the type of work measure up to the standard of that which they have been doing. For instance, we may use a teller in the position of assistant teller, or for some clerical work, until we find a proper place to locate him. It has been our experience in San Francisco that that problem has not caused any trouble whatsoever.

It is true that at times the payroll runs up rather high, but, in the long run, I think we are taking the right course, keeping the confidence of our employees and the assurance in their minds that they are going to be looked out for, irrespective of general business conditions. I think the esprit de corps of the employees is a mighty important factor. The personnel represents the most important asset we have in the banks.

Management and Accounting Control of Branch and Group Banks

By E. V. KRICK

VICE PRESIDENT AND CASHIER OF THE AMERICAN TRUST COMPANY,
SAN FRANCISCO, CALIFORNIA

Address before the Denver Departmental Conference

Mr. Krick defines branch banking as a system in which the branches are merely offices of the parent institution—extensions of it, but under its direction, with the same officers, management, and corporate existence. In group banking, each bank in the group is a separate corporate entity, with its own name, officers, and directors, operated quite independently of all the others in the group, but owned by the same central holding company or individual. These two groups are subject to the same general character of management and accounting control, and present similar problems.

Mr. Krick discusses their two main types of management: one, where all activities center at one point in the head office of the branch bank, or in the central office of the holding company of group banks; the other, where the units are, to all intents and purposes, quite independent.

Mr. Krick submits also four practical charts used in group or branch banks.

FROM the wording of this subject, the inference may very readily be drawn that branch and group banks are subject to the same general character of management and accounting control. But, while many branch and group banks have developed organizations which are comparable as to methods of management and control, others are to be found which are dissimilar. Any one attempting a study of this subject will soon come to the realization that branch banks, generally speaking, because of their longer establishment, are reaching a point where proved methods are adopted and changes are fewer. On the other hand, group banking appears to be facing many of the constructive prob-

lems that confronted the earlier branch banks.

In order that you may understand thoroughly the basis for this discussion, your attention is called to the fact that branch banking in itself comprises several varieties of organization designed to meet the needs of the branch bank, somewhat in accordance with the requirements of the territory which it serves.

Generally speaking, there are three types of branch banks: those that are confined to corporate city limits; those that serve commercial or metropolitan areas not restricted by political boundaries; and those that serve larger territories, or a state. It appears obvious that the character of management and accounting control of a branch bank

serving a city community may be different from that serving a large area covering many political divisions.

WHAT IS BRANCH BANKING?

It is generally understood that "branch banking is a system in which the branches are merely offices of the parent institution, extensions of it, but under its direction, with the same officers, management, and corporate existence." It is being assumed that group banks include those institutions termed chain banks. Here, as in branch banking, there are different types of group systems, varying somewhat in accordance with the size or needs of the territory served, and with the character of management applied. Generally speaking, however, it is considered that "chain (group) banking is a system in which all the banks in the chain (group) are separate corporate entities, each with its own name, officers, and directors, operated quite independently of all the others in the chain (group) but owned by the same central holding company or individual." One of the largest group bank organizations in the country defines itself as "a banking system whereby a number of corporately independent financial institutions retaining their own identity, capital, personnel, and management, are coordinated through majority stock ownership by a supervising holding company operated by the banking interests of the territory which it serves."

With these distinctions in mind, it is obvious that management is a very important factor. Banking management, whether it be management of an independent unit or of a branch system or a group system, when reduced to its simplest terms means little

more than placing responsibility on certain designated individuals or groups of individuals for obtaining deposits or other business, investing funds, and caring for the other types of business, maintaining a position whereby depositors may be repaid their funds promptly, conducting the bank in such a manner as to maintain the safety of its assets, producing a proper differential between income and expense, and rendering to the public a service repaying its confidence.

THE ARMY STYLE OF ORGANIZATION

In both branch and group banking there are two main types of management. There is one in which the flow of activities is comparable to the army style of organization. In this type of management, activities of every nature center to one point in the head office of the branch bank, or in the central office of the holding company of group banks. Approach to these points must be through a designated individual. In some cases this line of approach is so well defined that those desiring to approach head office officials have but the one avenue of contact, and a deviation is apt to bring severe criticism. This type of management has been giving way to the other form, that may be designated as management along parallel lines, whereby managerial activities are passed from a senior officer in the main office on through to the branches or units along the lines of his special responsibility. One senior official may be handling new business; another, commercial loans or savings loans or operations.

A review of the management of some of the group banks in the coun-

try brings out the fact that in numerous instances the banks are being managed in a way quite comparable to branch bank systems, although the units of such group systems are to all intents and purposes quite independent. In reality, so far as the public is concerned, the banks are independent from outside the counter, but behind the counter the organization is managed in all major matters from a central point. There are other types of group banks, however, where practically complete managerial responsibility is definitely placed with each unit of the group.

An inquiry on this point was made of a number of group banks, and one of the officers, in replying, wrote in part as follows:

"We have put emphasis upon the facts that when a bank becomes a member of ——— group, it retains its state or national charter, is subject in every way to the federal or state laws, retains its full complement of officers, has its own board of directors, and is managed in every way, and its policies shaped, by the people living in the community where it is located. Not only have we emphasized this in our information to the public, but the idea has been carried out in fact."

Even in organizations of this kind, the major policies of the organization are formulated by officials at the head office.

ADVISORY BOARDS

With branch banks it is customary to follow the plan of appointing advisory boards in various localities outside the head office city. It is interesting to note, however, in checking this particular point with a number of banks, that there appears to

be a decreasing interest in this type of management, and that the responsibility placed upon advisory boards seems to be generally limited to the development of business and to passing upon loans. With group banks the organization is such that the local board of directors for each bank is an essential part of its corporate set-up and carries responsibilities by law.

Some group banks have gone so far as to require that "where a holding company owns 75% or more of the outstanding stock, the shares of such bank or trust company owned by the holding company shall be voted in favor of the election of a board of directors, of which at least 75% shall consist of directors residing in the municipality where said bank or trust company is located, or within a radius of fifty miles thereof."

One group system serving a number of cities in a general locality has gone a step farther. Not only does each unit have its own board of directors, but each unit has a member on the board of directors of the holding company.

INDIVIDUAL RESPONSIBILITY

In the management of both branch and group banks there appears to be a trend away from the complete committee form of management. Wherever possible, responsibility is assigned to an individual; yet committees are retained for consultation upon the larger questions and for the dissemination of policies and information. In some of the larger branch and group banks there has developed a character of management in the way of a committee which brings together those charged with formulating the policy of the organization and those charged

with major responsibilities for operating the bank. This group deals only with major problems.

In business development or the obtaining of deposits and other types of business, both the branch bank systems and the group banks seem quite uniform in their method of management; that is, the local branch is expected to solicit new business and be constantly on the alert for business from new industries, individuals, or concerns that enter the locality, methods and procedure being checked by a department at the head office. In a few cases it was found that group banks use an agency for developing new business ideas. In the larger branch and group banks supervision of the new business work and of advertising is followed rather closely.

LOANING LIMITS

The investments of an institution may be classified in three general groups, loans, bonds, and other investments. With the exception of those group banks that have definitely thrown their units on their own responsibility, loaning limits have been generally assigned to branches, whether of the branch system type or of the group type. This method seems to be generally accepted as satisfactory, the assignment of the loaning limits, of course, being made from head office. Above the loan limits, head office approval is obtained. Handling larger loans in branch banking is a simple matter, as all branches may, upon head office approval, make loans up to the legal limit of the branch system. In group banking, each unit is restricted to the legal requirements based upon its own capital and surplus. In group banking, the

banks have a system whereby other units of the group may share in the larger loans. Loan policies, both in branch and in group banks, are defined by the various head offices, and the information is relayed to the branches, either by writing or by calling together branch and unit managers. The consensus of opinion seems to be that loan policies, being subject to constant change, are conveyed to the branches more efficiently by word of mouth than by the issuance of written instructions.

The bond account in branch banks is uniformly handled or supervised by a head office department. Most group banks handle the bond account in each unit under the supervision of a bond department at the head office, which in principle differs little from the system adopted by branch banks, except that custody of the securities is not centralized.

LIQUIDITY

The other type of investment ties in very closely with the question of liquidity. The branch systems may have some advantage in the immediate control of this important phase of banking. In branch banks the liquidity is cared for at the head offices, while in group banks each unit of a group maintains its liquidity, but its condition is closely watched by means of reports submitted to one of the officials at the head office of the holding company.

Management, as applied to the safety or security of the assets of the two types of organization, follows about the same line; namely, that of inspection, audit, and general supervision.

When it comes to income and ex-

pense, a wide difference develops in methods. Some branch bank systems permit each office to carry its own profit and loss account, the results of operation being checked from time to time. Other branch systems manage this feature of the work by carrying all income and expense accounts at head office, the income being remitted daily, and expenses paid by the branch being charged to head office in the same manner. Group banks, so far as could be ascertained, provide that all units carry their own income and expense accounts.

The character of service rendered by branch banks and group banks is supervised and checked in much the same manner by both types of banks. Some institutions require special reports or subsidiary reports from auditors or inspectors, and others, in addition, arrive at their conclusions by interviewing the residents in the community. In branch banks advisory board members play an important part in seeing that the branch renders proper service, while in the group banks the board of directors functions in this matter.

PERSONNEL

There is one factor which plays a most important part in both types of organization, and that is personnel. In all institutions the management of personnel—that is, the selection, the requirements of the staff, and assignments—either is definitely controlled from head office or is under close supervision. This control is maintained in some institutions by allowing no additional employees to be placed without approval from head office. All transfers are approved by head office, and all employees are checked

by some head office representative once or twice a year. Other institutions maintain a supervision of personnel by the use of personnel folders and interviews. With all branch banks that were approached, and with nearly all the group banks from which inquiries were made, salary increases are passed upon by a group from head office upon recommendation from the local units. There are some group banks, however, where both the personnel and the salary increases are handled locally but are reviewed from time to time by the head office.

ACCOUNTING CONTROL

The second division of the subject deals with accounting control. Interest naturally centers in more than merely the comptroller's activities. Some of the principal items to be considered in this section are the records relating to liquidity, investments in bonds, loans, branch clearing account, interest, accruals, other income, salaries, and other expense items.

From the standpoint of actual banking operations, whether branch banking or group banking, liquidity is one of the essentials. Where the liquidity is controlled at one point, as is the case with all branch banks and many group banks, the accounting is simple. In group banks where the control is one of supervision, the condition of the various units as to liquidity is supervised by review of reports. Some institutions have a very definite schedule upon which to work, setting up their experience against an ideal. A specimen of the form used is shown in illustration "A."

In the institution where this particular form is used, the report is

ILLUSTRATION "A"

*Bank with \$100,000,000 Commercial Deposits**and \$50,000,000 Savings Deposits. Member of Federal Reserve System*

	Present Actual Position of Bank	Ideal		Short Over
		% of Deposits	Amount	
COMMERCIAL DEPARTMENT				
1. Cash and due from banks..	\$28,000,000	25.00	\$25,000,000	\$3,000,000
Bonds and securities	8,000,000	10.00	10,000,000	2,000,000
Loans	64,000,000	65.00	65,000,000	1,000,000
2. Loans—Capital funds	10,000,000	.....	10,000,000	..... ..
	\$110,000,000	100.00	\$110,000,000	..... ..
SAVINGS DEPARTMENT				
Cash* . . . . .	\$ . . . . .	.....	\$ . . . . .	\$ . . . . .
4. Due from banks	2,500,000	3.00	1,500,000	1,000,000
Bonds and securities	8,000,000	20.00	10,000,000	2,000,000
3. Collateral loans	3,000,000	10.00	5,000,000	2,000,000
Real estate loans	36,500,000	67.00	33,500,000	3,000,000
2. Loans—Capital funds	10,000,000	.....	10,000,000	..... ..
	\$60,000,000	100.00	\$60,000,000	..... ..

1. Cash and due from banks includes: till cash, collections, exchange, due from branches, due from Federal Reserve bank, and due from banks.
2. Capital funds are the paid in capital and surplus, undivided profits, and reserves not invested in fixed assets, such as buildings, and so forth.
3. Collateral loans are considered as part of secondary reserves, and are principally brokers' loans.
4. Due from banks is reserve with Federal Reserve bank.

* Cash for both the commercial and savings departments is carried on the books of the commercial department.

made up weekly and submitted to officers who are particularly concerned with the liquidity condition of the bank. The report forms the basis for investment activity, loan policies, and reserves. This report is

bank, public, special. Illustration "B" is also submitted, giving an estimate of the amount of funds that would be immediately available in case of need.

The accounting control of invest-

ILLUSTRATION "B"

Recapitulation of Immediately Available Assets Combined Bank

	Savings Department	Commercial Department	Combined
Due from banks			
Available through withdrawal.....			
Brokers' loans			
Available through liquidation at call....			
Bonds			
Available through sale			
United States Securities.....			
Municipals			
Other bonds			
Eligible paper for rediscount			
Acceptances			
Commercial paper			
Customers' notes			

accompanied by other information, showing allocation and diversification of bonds, and showing trend of deposits under various classifications, such as demand, time, individual,

ments in detail varies with each individual bank. Many of the larger institutions, particularly those where the investments are centralized at one point, have developed systems where-

by the accounting of the investment department is absolutely divorced from contact with the securities, and the department or officer authorizing the purchase in many instances has control neither of the securities nor of the records. This is worked out by the use of requisitions calling for the purchase or sale of securities, checked by a member of an investment committee or by the officer in charge of investments. This requisition, issued in several copies, when properly signed, becomes instructions to the investment department keeping the records, and also to the custodian of the securities. In addition to this, one of the copies of the requisition is routed to the auditor, so that a complete check and control is kept up daily of all movements of the investment account.

Most institutions in principle maintain double custody of all assets and property held in custody. In some instances triple custody is maintained. Accounting procedure is so constructed that control of accounts and control of assets or other property do not overlap, but each acts as a check upon the other.

DAILY REPORTS

The accounting control of loans in branch banks appears to be arrived at by a method of daily reports to the head office. In many branch institutions a central liability is kept of all commercial loans, so that at any time officers at head office may check the loans of any one branch. The use of this record acts as a safeguard against double borrowing. Where a central liability ledger is kept in the commercial department, each branch reports daily all loans made and paid.

This report is used for other purposes, which will be discussed later. In group banking, judging from the answers to a questionnaire, the accounting control of loans is made through the use of reports and the periodical inspection and proof of the loan pouches in the various units.

BRANCH CLEARING ACCOUNT

The accounting relating to the clearance of interoffice transactions varies with the institution. Branch banks quite generally carry what is known as a head office or branch clearing account, through which all interoffice transactions are cleared. In illustration, if branch A sends a remittance to branch B, branch A charges head office account. Branch B, upon receipt, responds by crediting head office account; thus the transactions will wash each other. A transcript of all transactions passing through the head office account is forwarded to the auditor daily for reconciliation, showing date of transmittal letter, name of branch to which sent or from which received, and amount. In practice, those branch organizations having this method find it thoroughly satisfactory, and when once a system has been developed, altogether efficient. It appears obvious that this account, unless handled in a manner that keeps the exceptions down to a minimum and keeps the clearance of the exceptions to a limited number of days, represents one of the spots that bears watching. Some group banks follow much the same practice, while other group systems treat each unit as standing entirely on its own feet, and any transaction with a unit member takes the same position as a transaction with an outside bank.

CONTROL OF ACCRUALS

The control of accruals on loans and investments is obviously one of the most important factors in the accounting control of either group or branch systems. Many of these institutions, particularly where the profit and loss account is carried at head office, have worked out a system whereby all loans and investments are set up on a daily accrual basis. The branches are called upon once a month or once a quarter, depending upon the method of collecting interest, to prove their uncollected interest against the accrual figures. If these proofs show more than a small difference, an investigation is called for. This system of control of accruals eliminates one of the great hazards in branch or group banking. It means that the holding out of interest payments to any extent is practically an impossibility. Any institution that has not adopted this form of accounting practice will, upon investigation, find it a most desirable procedure to adopt. The comptroller of one of the larger branch banks very courteously furnished a memorandum descriptive of the method used by his institution in handling accruals. It is quoted below:

"In all banks interest earned is by far the largest item of income, and in branch banks, owing to the different rates of interest and the frequent changes in the amounts loaned, it has been very difficult to check accurately. However, we have found that the following system gives an absolute check on the amount of interest earned daily.

"Interest is accrued daily in the branches by taking the amount at each interest rate and multiplying it by a decimal, which is known to be the interest earning on \$1 at that

particular rate for one day. The total of all the interest earned, together with any other earnings the branch may have had during the day, is remitted to the comptroller's department each night.

"The loan journal in the branch is made in duplicate, one copy of which is sent to the auditing department and is used by it in calculating the interest earned by the particular branch for that day. This figure is checked with the amount of interest earned, remitted by the branch. We thus have the original calculation by the branch as to the interest earned checked by the auditing department, which, I think you will agree, should be correct as to the actual interest earned.

"When the branch makes the calculation as to the interest earned, it charges 'interest receivable' on its books and credits 'operating income head office.' When interest is paid, the entry is charge 'cash' and credit 'interest receivable notes,' thereby reducing that figure to the actual interest earned and uncollected.

"Periodically the branches are required to figure, from their notes or ledger cards, the actual interest earned and uncollected, which should agree with the interest receivable notes as shown by their general ledger.

"If the interest earned and uncollected as shown by the notes does not agree with interest receivable, it is evident that the mistake must be in the collection of interest, for the interest earned having been figured by two different people at different times, it would seem that we can accept this figure as being correct. If the branch is either over- or undercollected in interest, this situation will be reflected in the difference between the interest receivable on the general ledger and the interest earned and uncollected as figured from the notes.

"As an additional check from time to time, we have girls with comptometers go to the different branches and make an independent check of the interest earned and uncollected, comparing the result with the interest

receivable on the general ledger. Thus we feel that the interest earned is controlled in such a manner as to make stealing from this source of income very difficult.

"Interest earnings from investments in the form of bonds, and so forth, can be checked in exactly the same manner."

For other income, such as service charges, commissions, and the like, the various types of institutions have made installations to fit their particular needs. In some instances banking houses have met the situation by the installation of a form of charge tag which calls for the use of a bound book, leaving a carbon bound, while the debit ticket and mail advice, if the latter is sent, are removed from the book. The tags are all numbered, and periodically the auditor checks against the carbons in the bound book and against the primary records.

METHOD OF CARRYING PROFIT AND LOSS ACCOUNT

As has been stated, there is a variation in both group and branch banks in the method of carrying the profit and loss account. Some centralize at one point, and others provide that each branch or unit carry its own account. In the latter case the control is local and follows usual accounting practices, with an auditor coming in periodically to check. Where the control rests with a head office, expenses are paid locally. With many banks operating in this manner, the branch or unit uses a voucher check, the carbon of which is forwarded to the comptroller, together with the approved bill. The comptroller then checks the bill as to correctness and authorization for expenditure. In

some institutions a general control is attempted by the use of budgeting expenses for each unit, the budgets being determined upon by agreement between local and head office managements. This method, where given a fair trial, brings most beneficial results.

CONTROL OF SALARIES

Next to interest paid, salaries represent the greatest item of expense. The control of salaries ties in so closely with management and earnings that, so far as information could be obtained, it appears that salaries are controlled by the head office group. Even with many of the larger banks, no additional employee is taken on without approval first being obtained from head office. This approval takes the form in some instances of a requisition, such as the sample attached, illustration "C."

With the exception of a very few organizations where complete autonomy is exercised, salary increases are passed upon by the head office, originated in the branch or unit. The accounting control is complete and simple. Complete salary records are kept by the comptroller's department. Copies of all salary increase authorizations, copies of transfer, release, and new employee authorization slips are filed with that department. A monthly or periodical report by the branch or unit is sent in to head office for checking purposes.

In those organizations where the profit and loss account is carried at head office, the branch or unit draws, prior to pay-day, a check for salaries, head office being charged. Later, detail of the amount making up the charge is forwarded to the comptroller's department, head office.

ILLUSTRATION "C"

Requisition for Employee

Department or Office..... *Date*.....

Classification	Temporary or permanent
Salary range \$..... to \$.....	Replacing
Date wanted	If temporary, how long required

Qualifications: List in order of importance.

If additional employee, explain fully.

Additional Approved	Employees considered		Fate
..... V. P.	1.	.....	.....
..... V. P.	2.	.....	.....
..... V. P.	3.	.....	.....
..... V. P.	4.	.....	.....
..... V. P.	5.	.....	.....
..... V. P.	6.	.....	.....

Manager or Department Head

Other expense items, such as stationery, supplies, advertising, gifts, donations, subscriptions, in some instances are placed upon a budget basis, and in other cases items such as subscriptions, gifts, and donations, are referred to head office for approval. The comptroller's department is then in a position to catch any unauthorized expenditures.

It is the general custom of branch banks, as well as of group banks, to anticipate as far as possible the needs of the various units or branches where local autonomy is not assigned.

There are many records or accounts kept in all banks (whether branch or group) about the upkeep and balance of which the controlling organization, whether it be the head office of a branch bank or the head office of a holding company, has a very definite interest. The condition of such records is checked monthly in a number of institutions by the use of a certification sheet, copy of which is attached, illustration "D."

UNIFORM ACCOUNTING PRACTICE IN INDIVIDUAL BANKS

Uniform accounting practice, whether in branch or group banks, is one of the essentials of efficient management and control. With branch banks it has appeared the custom, the moment a branch is taken into an organization, to install the regular equipment of forms and systems. In fact, it is necessary that the new branch be brought into uniformity with the others. With group banks the same results are arrived at by suggestion from the supervising officer at head office, although in some group organizations it appears that the control of the unit bank is vested

locally. The installation of such records is not necessarily mandatory.

The general opinion given in answers to a questionnaire is that in those institutions where unit control is featured, the local management is very receptive in the matter of suggestions that will improve and simplify the conduct of the unit.

It appears obvious that accounting control in banking is flexible and easily adjusted to various forms of management. Banking is not different from any other line of business. The main factor in success is management. From this brief review it appears that various management groups are out of accord as to the best method or form of organization. Experience will furnish the answer. The type of management which renders the best, most economical, and most efficient service to the public, will be the one that will maintain itself.

Discussion

GEORGE ECCLES (First National Bank, Ogden): I think that Mr. Krick referred to our institution several times in his paper. The questionnaire which he sent out to assist him in getting the information for his paper came to us, and we answered it in great detail. I notice that he refers several times to "a certain group" that does this and that, and I conclude that our group is the one he refers to.

We have been operating a group banking system for about three and one-half years. We are one of the oldest banking systems operating as a group. There are several chains of banks throughout the country. Until two to three years ago, however, there were very few banking outfits

ILLUSTRATION "D"
Certification as to Balancing of Accounts

Branch No. _____

Month of _____ 19____

Acct. No.	Accounts and Records	Dates Balanced Most Recent Dates in Month for Which Certification is Made				Over	Short	When Lo- cated	By Whom Balanced Signature
		Date	Date	Date	Date				
1	Cash on hand								
2	Cash items not disposed of								
10	Collections—city								
11	Collections—out of town								
12	Collections—coupons								
13	Federal Reserve—2-9 day								
40	Warrants								
45	Accounts receivable								
47	Advances to borrowers—loan charges								
48	Interest receivable—notes—com.								
48	Interest receivable—notes—savings								
54	Acceptances discounted—trade								
60	Loans on real estate								
61	Loans on stocks and bonds								
62	Loans on U. S. war obligations								
63	Loans on other collateral								
65	Loans unsecured								
67	Advance accounts								
68	Loans on auto contracts								
70	Bills of exchange purchased—domestic								
73	Overdrafts								
74	Doubtful loans								
	Goods in warehouse inspected and verified								
501	Due to banks—domestic								
503	Cashiers' checks outstanding								
503a	Drafts payable								
504	Certified checks outstanding								
505	Certificates of deposit—demand								
507	Individual commercial deposits								
509	Inactive deposits—com.								
509	Inactive deposits—savings								
512	Escrow deposits								
520	Individual deposits—30 days								
521	Certificates of deposit—time								
522	Individual savings deposits								
522a	Christmas club accounts								
525	Postal savings deposits								
527	State, county and municipal deposits								
528	Other secured deposits								
532a	Accounts payable								
532b	Suspense items—overnight								
533	Loan commitments								
534	Safe deposit key deposits								
535	Deposits under attachment								
541	Loan charges collected in advance								
549	Unearned discount								
	Collateral value checked—secured loans								
	Liability ledger								
	Loan ledger cards								
	Installment collections								
	Travelers' checks								
	President—cashier trustee account								

INSTRUCTIONS: This schedule to be forwarded to cashier, head office at end of each month.

Detailed proof lists (Form GB4) in each of the various accounts set out above are on file. Each proof list is headed with title of account, dated and signed by the clerk who made the list. All exceptions (if any) have my attention. All stubs of cashier's checks, time certificates of deposits, certified checks, and so forth, have been proved to the daily general ledger credit totals.

 Manager

that endeavored to operate a group of banks nearly like a branch banking system.

We have in head office a purchasing department which handles the purchase of all supplies—the purchase of the equipment for the various units. The orders for these come in by requisition from the various units but are okehed by officials in charge at head office. We find that there is a great saving in the purchase of supplies through one central unit. On the item of purchasing checks we have been able to cut our cost so that it is about one-third of what the original cost was in each individual unit. We find that it saves considerable money, in getting quantity discounts, and so forth.

We also have in head office a securities division which has absolute control of the purchase of bonds and securities for the various units. In this securities division we have men who are trained and experienced in handling securities, and they can save considerable money for the institutions by handling the purchase of their investments.

We handle from head office all the advertising for the various units. We do not, however, attempt to dictate, as Mr. Krick put it in his address, the handling of the personnel. We do okeh the transfer of employees (I believe Mr. Lemm referred to this), but we do not okeh the hiring of new employees. We do, however, review periodically the salary list, to see that bookkeepers or tellers in one particular unit are not receiving too much compensation in comparison with the teller unit or the bookkeeping unit or any other unit in any other division of the system.

GEORGE V. H. BROWN (Bank

of Italy, First & Pine Branch, Long Beach, California): May I ask Mr. Eccles a question as to reserves? How are the reserves handled on the most economical basis? Of course, each bank must have certain reserves in cash. Does your head office maintain large cash reserves and move them around as reserves are needed at the unit banks, or does each bank maintain a reserve over and above the requirements?

MR. ECCLES: I covered that matter quite fully in my paper yesterday at the Credits Conference. We find that in group banking systems the conserving and centralizing of reserves is one of the best sources through which to save expense. We find that by the proper installation of transit methods we can cut down on the number of city correspondent accounts. Some of our city bankers may not approve of this method, but we find that by it we can concentrate the reserves of the various units in the group in one or two of the larger banks in the group and give them the full benefit of the city correspondent account.

In other words, they can send their transit letters direct to the city correspondent, and these will be credited to the account of the larger bank which is carried by the city correspondent, and will, in turn, be credited to the account of the smaller bank. That cuts down the necessity of each individual unit's carrying its own city correspondent account for the purpose of handling transit business. However, we do this:

We require that each unit stand on its own feet from a liquidity standpoint. The units are required to maintain a certain cash reserve with one or two or more of the larger banks in the

system. That cash reserve is based on the activity, the volume, that particular bank has. Then, we require that each unit have its own secondary reserve. That is, a certain percentage of its assets must be invested in bonds, commercial paper, call loans, and so forth. If it has surplus funds (I think that is the point you are referring to) beyond this point, these funds are concentrated in one or two of the larger banks in the unit, and an excess rate of interest is allowed on the daily average balance.

The rate of interest which is paid depends upon the average earning rate of the larger banks in the unit. This allows each individual unit the full earning power of its assets without making it necessary for head office at all times to see that these funds are invested up to 100% in each particular unit. It means that head office, then, or the management of the larger banks in the unit, has the problem of keeping the funds working, but this problem is not extended to each small unit within the group.

MR. BROWN: In this group I imagine you have both state and national banks, do you not?

MR. ECCLES: Yes.

MR. BROWN: Does the State of Utah authorize branch banking as yet?

MR. ECCLES: No. We operate in three states, and no state in which we operate authorizes branch banking to any extent. They don't allow tellers' windows or offices.

ALAN WARNER (Chatham Phoenix National Bank and Trust Company, New York): Perhaps you covered this in the Credits Conference, too: What do you do with excessively large credit lines? Do you distribute these among larger banks in

the system, or pass the paper on without recourse?

MR. ECCLES: I did cover that in my paper, if you would like to refer to it. We give the management of the individual unit the authority to pass on credit lines up to the legal limit without first submitting them to the head office for approval. Excess credit lines originating in any unit must first be okehed by head office. Then head office advises this unit or this particular bank how to handle this particular excess credit line.

In the majority of cases, because of the concentration of reserves in one or two of the larger banks in the group, these larger banks have excess funds available for investment, so that the excess portions of the credit lines are carried by these larger banks that have the excess balances. The unit originating the credit line carries a participation in the credit line up to its legal limit in order that it may follow up the credit line and have a personal interest in it. Loss is absorbed by the banks in pro rata proportion to their participation in the credit line. However, in preparing my paper for the Credits Conference, I found that some of the group systems in some cases require the originating bank to subrogate its participation in the excess credit line.

MR. BROWN: As to examination of these banks, do the national examining department and the state examining department come together and examine this group as a whole and at the same time?

MR. ECCLES: That is one of the problems today in group banking. I think one of the legislative requirements which we need in this country is to have proper supervision of group banking. At the present time a state

banking examiner comes into a unit in the group just as he would come into any individual bank. That is, he doesn't come in at the time the national bank examiner does, or examine each unit at the same time. He just drops in whenever he is in the territory or whenever he would ap-

pear in your particular individual bank, and there is no coordination at all in the examination of the various units. We do, however, maintain a complete auditing and examining department in head office, which makes a thorough examination of each unit at least twice a year.

Business Development
and
Advertising

How to Find and Approach Corporate Depositors

By JOE MARTYN TURNER

JUNIOR VICE PRESIDENT OF THE BANK OF AMERICA OF CALIFORNIA,
LOS ANGELES, CALIFORNIA

Address before the Denver Departmental Conference

How to find corporate depositors is as much a problem as how to approach them. There are, of course, the usual channels open to all banks: publications which chronicle the opening of new businesses and the change in ownership of established businesses; daily papers; trade journals; friends; correspondent banks; industrial realtors. But just as important as any of these avenues of information is the personnel of the bank. The observations of a wide-awake personnel are invaluable.

There are certain specific advantages which the bank has to offer its new depositors: first, convenience of location; second, improvement of service; third, economy of operation; and, fourth, enlargement of credit facilities.

There is also the fact that branch banks have so many branches scattered throughout the state that they are conversant with conditions affecting the entire area; as a result, when a depositor wishes first hand and intimate information on local business conditions in other communities, the branch banks are in a position to satisfy his needs.

I AM going to interpret the topic assigned to me as meaning "How to find and obtain corporate depositors"; not "How to find and approach corporate depositors." If, in my consideration of this subject, I should dwell upon the merits of the branch banking systems, I am sure that I shall be pardoned. My experience has been almost 100% branch banking, and the leaders of your conference, knowing this, I am sure did not anticipate that I would quote from the writings or sayings of unit bankers. We in the branch banking field must naturally develop any subject from the branch banking viewpoint.

Now let us consider how we are to find the corporate depositors whom we wish to approach. We have those

avenues which are open to all banks. We in California have a publication known as the Abstract from the Records. This publication announces any change in the status of firms or corporations. It also chronicles the opening of new businesses and the change in ownership of established businesses. We have the daily papers, which constantly announce the organization or opening of new industries in our territory. We have the trade journals, that pay particular attention to given industries. Our friends and our correspondent banks are ever on the alert and constantly tip us off regarding nationally known enterprises that are opening California branches. We receive many leads from our industrial realtors. These men, operating in in-

dustrial tracts, receive the first indication that a new corporation is contemplating purchasing property for the erection of a factory in the area served by our bank. From the foregoing, you will see that we find our corporate depositors just as any other banks finds its corporate depositors, through legal notices, through correspondents, through friendly depositors, and through the observations of a wide-awake personnel.

While we are talking about a wide-awake personnel I should like to mention a wide-awake solicitor who proved to be of value to his bank. A friend of mine in the business development department of a California bank, was driving down Wilshire Boulevard. This is a nice, quiet little street in Los Angeles between eight and nine o'clock in the morning, where, if you don't make better than forty miles an hour, you are quite likely to have your rear fenders ruined. My friend, in his attempt to keep up with the traffic conditions, suddenly found himself about to be sideswiped by a large truck bearing the trade mark and slogan of the Heinz Pickle Company. Synchronized with the jamming of his brakes, was his reading of the signs on the car, and the thought, "Have we this account?" When he arrived at the office he immediately investigated and learned that his bank did not have it. He stepped out and developed a contact which brought him a substantial account.

WHAT HAVE YOU TO OFFER THE PROSPECT?

The development of new leads is only the first step toward the acquisition of new business. Banks of ap-

proximately the same size, departmentalized in the same manner, have difficulty in obtaining accounts from banks of the same general make-up. We in the banking business must admit that a continued relationship between a depositor and a depository grows in value with each succeeding year. However, we in the business development field would be sadly deficient if we recognized this as an insurmountable barrier in weaning depositors from our competitors. There are certain fundamental principles on which a new business man may approach a new depositor: first, there is the question of convenience of location; second, the improvement of service; third, the economy of operation; and fourth, the enlargement of credit facilities.

There are numerous angles of the branch banking set-up that we believe promote the advancement of these four conditions. For example, every branch bank in California, through its many branches, is able to offer convenient banking services to our large corporate industries.

DISPENSING OF NECESSARY INFORMATION

Our California branch banks have so many branches scattered throughout the state that they are conversant with conditions affecting the entire area; this circumstance naturally recommends their credit interchange facilities to the large corporations. Recently, a representative of a nationally known chain store organization, one of our depositors, told me when I was visiting his office that the organization was giving serious consideration to one of its stores in an oil town. It was considering either the enlargement of

its set-up or the elimination of that set-up. It was also considering the opening of a store in one of our up and coming cities. Because of the fact that we have banks in both of these towns, I was able to give first hand and intimate information on local business conditions in both of these communities, which will be of decided value to our friends in making their decision. So much for an illustration of what information we can furnish regarding general business conditions.

A recent contact by one of our representatives developed the fact that a large credit reporting agency was interested in obtaining for its clients first hand and intimate opinions regarding firms in the needle industry. Our bank, through its many branches and through its close contact with the retail trade, was favorably situated to make a decided impression upon this organization.

Our appeal to corporate depositors is based on several important factors, two of which are worthy of prime notice. We believe, first, that we are able to render satisfactory service in considering the element of time, on account of our many convenient locations. We believe we can effect a saving to our depositors by a reduction of float items, this being accomplished through our system of inter-branch deposits, which permits deposits at any of our branches for the credit of a depositor at some other branch. Recently we opened an account for a large corporation and are accepting deposits at twelve different points for the credit of its account at one of our central offices. This inter-branch deposit system is of advantage to our depositor for the following reasons: It eliminates the necessity of our depositor's carrying several bank ac-

counts for the different points of deposit and the subsequent reconciliation of the accounts. It develops an account of considerable proportions by the concentration of various branch deposits in one central account. The apparently larger average balance thus maintained is a factor which assists him in securing credit accommodation.

Discussion

CARL E. LINDQUIST (Puget Sound Broadway Bank, Tacoma): Mr. Turner, do your directors help you in securing business? I have in mind a bank near us—and for that matter, our directors do the same thing—in which their directors go to some of their close friends, particularly people from whom they buy merchandise, thereby using some little pressure to bring in an account.

MR. TURNER: I should say that a representative board of directors is one of the most valuable adjuncts to a new business department that any bank could possibly have. Answering the two phases of your question, first as to the help we receive, we have found it is whole hearted. They are representative types of men in various lines of business and I know not so very long ago, I obtained an account because I was able to get one of our directors who is constructing a building to purchase a load of steel from a certain steel fabricating organization.

We are setting up in our bank at the present time what we are calling a commodity file. Obtaining new accounts is very much a matter of merchandising. When we get one man to buy something from somebody else, we have made two friends and possibly obtained a depositor for the

bank. We are setting up that commodity file on the people who have accounts with us. We are going to elaborate on that and set it up on people who do not have accounts with us. We believe in the theory of "you scratch my back and I will scratch yours."

HOMER B. SHAFFER (First National Bank, Baltimore): Mr. Turner, to what extent do your branches depend on your home office for their central file or the development file or whatever you call it? I mean your city branches and not statewide branches. Do the city branches keep their own files of the new business, or is this information kept at the central office in the city?

MR. TURNER: We have in our

branches—and I think this is true of most of the branch banks in California—central files on our customers, but those are limited to the two major cities, Los Angeles and San Francisco. Each branch manager has on his desk a file which he is supposed to keep up to date on new contacts or people he wishes to be contacted. Ordinarily the branch manager is the best man to make the contact, but there are times when he wants a little moral support. In Los Angeles we have a certain number of men who have territorial supervision of the new business activities of each branch. I don't know how many branches we have in Los Angeles—I left there four days ago and I can't keep up with them.

Sales Arguments for Correspondent Bank Prospects

By CHARLES N. EVANS

ASSISTANT CASHIER OF THE FIFTH THIRD UNION TRUST COMPANY,
CINCINNATI, OHIO

Address before the Denver Departmental Conference

Mr. Evans is more concerned with sales attitudes than with sales arguments. The solicitor must center all of his attention upon the prospect; he must know his name and his title before he approaches him; above all, he must consider the patron's personal idiosyncrasies.

The experienced solicitor can find a personal contact when the usual selling methods are failing. Sometimes it may be a particular experience, sometimes a sentimental association; in any case, the salesman must watch for any possible lead offered in the conversation. The solicitor must show an active interest in the patron, and in the patron's bank rather than in his own.

Bank solicitation depends largely upon the individual workman. The salesman is the representative of his bank; it is his personality which reflects for the patron the personality of the bank. If he is loud, over-jovial, and vulgar, his bank will not gain the respect of the prospect. It is, in the final analysis, the personality and experience of the salesman that secures the account.

THE banker "salesman" labors under a handicap, compared with other "knights of the road."

When salesmen for commodities and merchandise, as for instance, things having to do with milady's fashionable wear, or even the rougher articles pertaining to mere man, when that salesman comes to town, his trunks are moved to the hotel, and in short order the sample room is dressed in dazzling array.

His goods reflect the varied tastes of artists, who lend a touch of color or of style at variance with the offerings of his competitors, and usually the price scale has tension screws that allow wide play, adjustable to circumstances and conditions.

Thus set, what does that salesman do?

He brings the buyers, one at a time, into the quiet seclusion of a fairy-land transformation, where there are no interruptions, nothing to divert from *the straight business of selling*.

And now for the bank salesman; what does he do?

See him pack his grip, only the necessary linen, and so forth, a stack of his bank's statements, copies of which, in ordinary course, have been regularly mailed anyway, and your bank salesman is ready for the train.

Follow this young man as he enters the building of his prospect.

Before entering he has carefully consulted a pocket directory, to fa-

miliarize himself with the names (if unknown) of the bank officers, and woe be unto him if he addresses Mr. Jones as Mr. Brown. This is frequently done, and ordinarily would seem, and ordinarily is, a small matter.

But many people are unreasonable about this; many seem to think that their names and stations should be known to the world at large, and such people are ordinarily very sensitive.

Desk name-plates are not altogether reliable. Frequently, as the result of an absence, one officer may be seated at another's desk and the name-plates not shifted, even should there be these useful "traffic signs" to guide the stranger.

The experienced campaigner will tell you that the responsibility of locating and correctly addressing the proper man is one of many difficulties he has to meet.

It is fatal to flip open your pocket directory, inside or even immediately outside the prospect bank; some eye will catch the movement, and will discount your warm greeting, indicative of seasoned acquaintance and friendship.

The experienced campaigner will also tell you that, in many, many cases, the man before whose eyes you lay your card will be considerate in all other respects but one: he fails to give his own name, probably from the fact that he is one of the class previously mentioned, or from the conclusion that the caller knows what he is about. After the visit, it is customary for banks to follow up the calls of representatives with a cordial letter confirmatory of matters outlined during the interview. Should, therefore, this letter be addressed to Mr. Jones, who at the time of the visit

may really have been at home with the mumps, and not to Mr. Brown, with whom the interview was held, your trolley slips off the wire!

I am stressing this subject much, but not too much. Idiosyncrasies are common and varied, and in the solicitation of bank relations must be allowed for.

In the meantime, our solicitor is in the lobby, and quite often, especially in small banks where working forces are limited, there he must stand, sometimes for half an hour or more. Unless personally acquainted in the bank, he cannot tell whether the man at the desk or serving the window is the president, the cashier, the assistant cashier, or a teller, and yet he must be sure of his approach.

How then is he to be sure?

The safest plan is to be practical and frank, and ask when in doubt. If you can get the attention of a teller or a bookkeeper, it is proper to extend your card and request that it be given the president or such officer as you wish to see. Do not use the officer's name, for banks change officers over night sometimes.

And if the one you address be a lady and give her name, disregard all appearances and call her "Miss." If she be married, the offense is slight; if she be single and you say "Mrs."—that's another story!

Are these things trifling?

I should say not, for the injunction "Despise not the day of small things" applies with especial force to the bank solicitor.

THE PATRON'S BUSINESS COMES BEFORE YOURS

The solicitor must be most careful not to permit his call to interrupt the

current routine of any part of the bank's business; he must always keep before him the idea that the bank he is visiting is much more interested in its local clientele, with money or business to contribute, than it is in propositions involving correspondent relations. Therefore, when you observe a nervous glance going over your shoulder, in the direction of some waiting or approaching customer, be quick to give way and bide your time, even if it means cooling your heels on the lobby tile for an hour or more. The psychology created in thus showing interest in the bank's advantage is favorable.

WAITING, A TEST OF SPORTSMANSHIP

This "heel cooling" business on the lobby tile is a severe test of good sportsmanship on your rounds for correspondent relations. You may be far away from your projected night stop; your schedule for departure may be close at hand, with weather and local hotel accommodations against comfort and convenience, but your chances are far from good if you overlook those nice little evidences of consideration which contribute to a pleasing personality.

It takes well balanced personality, by the way, to give one an even mental and spiritual keel while enduring the many prolonged and apparently unnecessary waiting periods to which bank solicitors are frequently subjected. Some are necessary, the home banker being defenseless against some customers who, like Tennyson's brook, "go on forever."

Your solicitor has come from a big bank, where business details seethe around his desk like bees around a

hive; therefore, if he is leaning on a check desk or counter, with only the diversion of reading calendars, blank deposit tickets, and so forth, for an hour or more, a good deal of spiritual enthusiasm wanes, but he must not show it!

There are a few other injunctions that should be observed by the solicitor seeking business for his bank, whether in correspondent or any other relations. He should stand clear of commitment and, if possible, refrain from discussion of closely drawn questions relating to politics, religion, creed, or policies not concerned with his immediate work; of course he should stand clear of adverse criticism of other banks.

THE SOLICITOR REPRESENTS THE BANK

When on his mission, he is first and last a representative of his bank; he is a seeker of business from those affiliated with all creeds and adherences. Outside of his bank he exercises the personal liberty of a citizen, but even in doing this, he should avoid assuming the role of a "rooter," since it is a tendency of the public to hold closely the association of a man and his business, and the undercurrents of thought and prejudice, particularly in silent channels, run deep.

Flattery and excessive praise should be avoided, as constituting cheap veneer, while the sincerity of an honest and fair expression, supported by fact, will contribute to the solicitor's prestige. I mention this because there are too many instances where an indifferent or weak bank statement is given complimentary comment, as little deserved as really felt,

the purpose being to be ingratiated into the favor of the prospect. It is far better, if comment be made at all, that it be frank, and of a character which the solicitor would, in confidence, give his best friend. Reasons for this are obvious. One is that the solicitor is likely to be quoted; another is that in giving undeserved praise he is setting a dead-fall for his bank's comfort, should doubtful credit be applied for; and still another is that the real grey matter and business acumen of the officer solicited may not be reflected in the statement. It must never be overlooked that active officers have to swallow many distasteful doses, from spoons held by hands higher up.

I would stress again the fact that flattery and false praise often prove a boomerang that smashes against the intelligence of the author. Some solicitors employ it carelessly or through inability to appraise correctly mental characteristics. For these, and many other reasons, a solicitor for bank relations should be most carefully chosen, and well coached before taking the field, for wherever he goes, whatever he does or says, he takes the bank with him. He cannot disassociate himself from his bank, and the prospect is bound to judge his institution by the character of the men representing it.

The solicitor must be tactful and a quick and accurate judge of human nature, and his general qualities should blend evenly personal magnetism, intelligence, and good breeding. He must not be a patron of "whoopie," one who thinks the bank he enters may be turned into a playground, where the latest, and perhaps some off-color, jokes will be relished. In a sense he is a stranger; therefore

he is the focus of calm, appraising eyes and mental judgment, a judgment that is seeing, through him, the bank he represents.

Now and then you will meet a solicitor whose idea of the work has descended from impressions of the rotund, jovial "drummer" of other days, who, with cigar twisted in the corner of his mouth, and clothes that shrieked their way to attention, won his way through conviviality and a disposition to entertain. A certain amount of entertainment is proper; too much is vulgar. A modified example of this type is met occasionally, engaged in work for an outside bank, but he is not met often; his career usually bears a meteoric or sky-rocket aspect, in which the flash is succeeded by empty space.

Bank solicitation draws more sharply down to the individual workman than is the case in any other line. If he is expert, he will make a quick appraisal of his prospect, his prospect's surroundings, and, in a general summary, of many things that would entirely pass the uninitiated or slow thinker.

FOLLOW THE PROSPECT'S LEAD IN CONVERSATION

He will add to those things by placing his prospect in the lead in conversation, realizing that the inherent interest of man in his own acts, his own creations, his own words, is greater than in the activities of another.

Here, naturally, are afforded openings for the solicitor's work. He finds the trend of his prospect's thought, whatever the subject may be, and, if his conversation turns toward any special feature of his bank's statement,

or of his individual activity represented therein, here is a lead that the solicitor should stick away in his memory as carefully as a squirrel buries nuts for future use! Men like to have you talk to them of their accomplishments, like to have you listen well when they are engaged on the same subject.

Therefore, the best approach is not the excellence of your own bank's service or history; this is generally known or may be enlarged upon later; seek rather to play a responsive chord that will find reverberation in the sentiment of the prospect.

Bank men, in characteristics and idiosyncrasies, differ in no respect from the rest of mankind; the experienced solicitor can tell you of strange fads and fancies that pervade the ranks, and he is keen to watch for them.

I was told once of this case: A large bank had failed in every attempt to secure much desired relations with a prosperous country bank that was largely a family affair, in that the president was the father of the two active officers, the cashier and the assistant cashier. Previous solicitation work had been with the president, the latter being the one who directed correspondent relations. *

USING THE PROSPECT'S IDIOSYNCRASY

This time, however, the solicitor first cultivated the assistant cashier and managed to get him interested. When told, as usual, that his father had the whole matter in hand, the solicitor replied that all previous effort in that direction had failed. The assistant reflected for a moment, then with a twinkle in his eye asked, "Did

you ever notice and refer, in your conversation with Dad, to the large diamond ring he wears?"

"Why, no, what about the ring?"

"Oh, well; nothing much," answered the assistant, still laughing, "but you might notice it, and make some complimentary comment."

The solicitor lost no time. Scarcely was he seated at the president's desk than he glanced with interest at the hand of the latter.

"Ah, excuse me, Mr. Blank," said he, "but could I have a closer look at that beautiful diamond you are wearing? Seldom have I seen a stone so brilliant."

"Sure thing," quickly responded the president, extending his hand, and edging his office chair closer, "and seldom do you see a stone that carries a sentiment like the one behind this.

"You see," he resumed, "I grew up a poor country boy without money or following, and with but little education. I had a good friend, young fellow in my same fix. We worked in a sawmill, and one day decided to deal in cattle, in a small way, and as a side line. With a few dollars saved, and the rest borrowed, we rented a patch of grazing land, bought a few cattle and started.

"For the first two or three years, we dealt hand to mouth, with local buyers, and they were getting all the profit. Finally, I persuaded Bill (my partner) to go in big by borrowing all the money we could, and when the cattle were ready for market, to take the drove, ourselves, to Chicago.

"Well, we did just that thing. We had a good year, and happened to catch a high market and I says, 'Bill, let's load and go!'

"Never will I forget how Bill's

eyes stuck out and how my heart beat when everything was figured up and we got our check. We went immediately to the bank and drew the hard cash.

"'Now, Bill,' says I, as we were passing a jewelry store on our way to the depot, 'let's stop right here and each buy a diamond ring, to wear as a memorial of this day, for all our future lives!'"

"Bill was agreeable, and we did just that thing. Diamonds were much cheaper in those days, so, as you see, we got something nice. And, young man, that very ring has bossed me ever since, in trading for myself. It inspired me among other things that proved profitable finally to buy the control of this bank, and every time I am doubtful of a transaction I glance at this stone; if it glints red, I stay off; if it glints clear and white, I am inclined to deal."

"Did the young man get the account?" you ask.

Not then; it was growing late, the lights were on, and he was afraid there might be a red flash. He simply talked cattle, self-made men, and so forth, and when he got home had his president write a nice letter with pleasant reference to early cattle days and the diamond incident; and a future event indicated that the stone must have flashed white while the president's letter was being considered!

In facing your prospect, remember that usually a key may be found that will unlock doors to any individual's interest. It is the matter of selecting this key that largely determines the efficiency of the salesman. To start simply with the purpose of convincing your prospect, by sledge-hammer blows, of the excellence of your

bank, is a waste of time. You will observe that his interest is listless and that he is glancing over the top of your statement, or over your shoulder, to see what is going on in his own bank. It is far better to keep your statement in your pocket for the time, and to express interest in his own.

He knows that you represent a good bank; he has seen your statements often; therefore, probe for his interest by striking upon some subject you have reason to believe lies closer to his thought; then work up to your own.

NECESSITY OF FAMILIARITY WITH THE PROSPECT'S BANK

The value of previous study and familiarity with the prospect's bank is great. If you carry a file relating to it, you should review it carefully before starting out, and store away in your mind things that might form a basis for your opening. Select these carefully. Do not dig out any skeletons, unpleasant misunderstandings, or the like. Keep these in your mind, of course, and ready to support your side if there be occasion, but never disturb the dead, unless forced to do so, for, while it may afford you inward satisfaction to prove the correctness of your bank's attitude in some transaction, long since "water under the wheel," when you do this you prove the incorrect attitude of the other fellow, and people do not relish having thumbs stuck in their eyes, or being shown up as the under dog in a scuffle.

Only in closing this address will I attempt to suggest any direct arguments that may be useful in securing bank relations, for when you get

right down to facts, about ninety per cent of the argument that puts the account across depends upon the personality and experience of the salesman and the psychophysics of the prospect. Other good banks are all around, banks as good as your own, and banks offering terms equal to or better than your own. They are sending out representatives who are constantly pulling the prospect's latch-string.

USEFUL SELLING ARGUMENTS

What arguments, therefore, constitute the remaining ten per cent?

First comes consideration of the natural relationship and trend of business between the prospect and the territory within your active zone. A little chat with the tellers will give you insight as to this trend. Water can be made to run up hill only by force, and force is costly. Banks find it so when meeting competitive terms for clearing business that is not on neutral territory or logically their own.

Transit in the collection of checks is an important study. Your solicitor must know his own schedule as well as those applied at competitive centers. If your bank, through location and facilities, can save the prospect two days in realizing on his outside checks, and interest balances are yielding the prospect, say, three per cent, make him see that on \$6,000 of such business you can save him \$1. In the present economic period of adjustment a dollar speaks loudly and is heard.

Do not flim-flam or slosh around in discussing loans and rates to the prospect bank. This discussion generally comes up quickly, introduced

by the prospect, who would seek a definite commitment against obscure and indefinite future business and balances. One-sided bargains should have no place in banking, and the wise solicitor will always have an anchor to windward that will hold his bank off the shoals of loss. Put your prospect on the defensive in this. He will not deny that his own loans are pledged on definite commitments.

Frankness and honesty of expression go a long way in salesmanship, as does fairness toward competitors. If some competitor is giving or offering better terms, admit it, if questioned, and do not throw mud in doing so. Your subject is your own bank, and if you are worthy of its hire there are excellent lines of its service that you can present in an engaging way.

FURTHER HINTS FOR SOLICITORS

In all solicitation avoid the personal pronoun; using, in place, your bank's name, and bringing it in as often as is consistently appropriate. Let the personal equation impress itself only in how you handle your subject. Be politely persistent, with a tinge of enthusiasm, and always keep in mind the contagion and magnetism of cheerfulness.

Do not take "no" too seriously when given to you the first or even the second or third time, remembering that inherently all prospects assume, at first, a distinct defensive against the seller of anything.

And, finally, never permit yourself to get "mad," or to show offense. "Whom the gods destroy, they first make mad." The door that let you into the bank swings both ways. If the atmosphere within is not con-

genial, there is room and sunshine outside, and take some of the spiritual sunshine out with you when you go.

Discussion

R. S. RACEY (The Chase National Bank, New York): What is the relationship of solicitation of correspondent bank business and the solicitation of commercial business in the town in which the bank is located?

MR. EVANS: The bank I represent, the Fifth Third, has about a thousand bank correspondents. We make it an absolute rule never to solicit a commercial or industrial or individual account of any kind in the city in which we have a correspondent until we have first gone to the correspondent and told them that so and so in their city wants to do business with us. We also write the prospect and say, for instance, "We might be able to serve you through our correspondent, the Chase National Bank," but we never solicit; therefore, my knowledge of how to proceed in that case is obscure.

CECILIA KIEL (Mercantile Commerce Bank, St. Louis): Do you have any method of getting to your solicitors data or reports of previous calls that have been made in the same territory perhaps six or eight months before?

MR. EVANS: We require all of our men who represent us to make a detailed report. I am sorry to say, I had the pleasure of putting in this system and it is acting as a boomerang that is hitting me now. When we solicit a bank, we make a careful write-up, not the next day when we can dictate to a stenographer, but that night. We send the original to the bank and retain the carbon copy for

reference which we consult when we go back later. This record shows every man and every woman we met in the bank, their full names, and everything that is discussed.

THE CHAIRMAN: I should like to ask this question: Is it your practice to restrict bank solicitation to certain officers who have that definite duty assigned to them?

MR. EVANS: We have five officers—I am one of them—who handle the business of correspondent bank relations. Sometimes when we are very busy and there are meetings going on, as at this time, we will go into other departments and take one or two of the officers of other departments and send them out, but they are familiar with our system and that system is followed.

CARL E. LINDQUIST (Puget Sound Broadway Bank, Tacoma, Washington): Does your bank have a definite policy as to loans to officers of the bank you are soliciting, carrying stock of their own bank for them? Is that a fair question?

MR. EVANS: It is a question that I can answer very easily. There isn't a bank represented here today that does not sometimes have officers of another bank who try to get that bank to carry individual loans on their stock, or something of that kind. We have that situation all of the time. In dealing with our correspondents, we tell them that they are entitled to a certain line of credit. We do not specify the amount, but we say, "The balance you are carrying with us obligates us at all times to extend you direct loan accommodations. Should you ask us to handle an indirect loan, that is something that must be considered on its individual merit, entirely independent of the bank's business."

Selling Personal Checking Accounts

By KIT CARSON

MANAGER OF THE NEW BUSINESS DEPARTMENT OF THE UNION TRUST
COMPANY, LITTLE ROCK, ARKANSAS

Address before the Denver Departmental Conference

The most effective weapons in selling bank service are those used in selling mercantile commodities; namely, advertising and personal salesmanship. A useful method of advertising, to be used in addition to the newspaper and direct mail, is the reprinting of newspaper advertisements on the back of the commercial statement sheets.

Personal salesmanship is perhaps of even greater importance than advertising. Few banks use all the possible groups of the selling force. The four groups—officers, employees, directors, stockholders—are of paramount value as selling agents, and should be used to the fullest possible extent. Many good contacts can be made also by the proper solicitation of newcomers.

Mr. Carson is concerned only with the profitable account, but there are various ways of changing the unprofitable account into a profitable one. Advertising and the service charge have both been used for this purpose.

An additional reason for the importance of selling personal checking accounts lies in the fact that they often lead directly to other profitable and desirable business for the bank.

THERE are many effective ways of selling personal checking accounts in your bank. At the very beginning I want it understood that in referring to personal checking accounts, I have in mind only the profitable account, or that account that can be made profitable. A little later in my discussion I shall touch upon the unprofitable account and attempt to show you that many such accounts (of a personal character) can be transferred to the profitable side of the ledger; or, if that is not possible, that this matter may be discussed with unprofitable customers so as not to leave with them a bad impression of your bank.

The selling of every bank service,

being a merchandise problem, places at your disposal just two effective weapons; namely, advertising and personal salesmanship. A great many business men have the mistaken idea that either advertising or personal salesmanship can be used exclusively. This is not true. These two sales weapons correspond to the two military forces at the disposal of a government to carry on either a defensive or an offensive military campaign, the army and the navy. In the recent World War, no sane and intelligent man would have said that the United States Government could abolish the army and rely on the navy, or vice versa; and this would hold true even if the war were to

he fought on American soil. We know that both these forces are necessary to win any war. In like manner, no bank can dispense with either advertising or personal salesmanship. Both are necessary to conduct an effective selling campaign, and that, regardless of the service or department to be featured.

ADVERTISING

Advertising will help materially in selling personal checking accounts. There are many ways and means of advertising. The best known are newspaper space, direct mail, outdoor, and street car. However, there are still other ways, such, for example, as publicity and satisfied customers, both of which are productive of good results—even more so at times than the paid-for advertisement.

There are many well known advantages that come to the individual from carrying a substantial personal checking account. There are many ways in which these advantages, either singly or grouped, can be presented in an interesting manner to your customers and friends, in comparatively small newspaper space. The advertisements of your bank on this subject may take the form of a campaign and may run regularly, either weekly, semi-weekly, or daily, the main idea being to continue your campaign along the line of "substantial balances in your checking account" until such time as the message has been thoroughly placed before the public in the press.

A very effective method of getting over to your customers the idea of carrying substantial balances in their checking accounts can be accom-

plished by having reprints of your newspaper advertisements placed on the back of your commercial statement sheets. This suggestion applies particularly to the treatment of your unprofitable accounts and the advertising copy used in that connection. Banks everywhere are finding that they have a valuable advertising medium that is effective and inexpensive, in their commercial statement sheets.

In the various departments of every well organized bank there are hundreds of customers who are using only one department. Many of these can and should carry a personal checking account. It would be an easy matter to make up a mailing list of such customers, selling them the idea of carrying their personal checking accounts at your bank. In some cases a form letter that is skilfully multigraphed so that it assumes the appearance of an individually typed letter will pull the account desired. In other cases attractive printed folders may be enclosed with letters or mailed independently. In using the various forms of direct mail you have a little advantage over newspaper advertising. Generally speaking, in making up a mailing list, some care is given to the selection of your prospects. You can employ colors, which always appeal, and you have practically unlimited space in which to set forth attractive messages. By this I mean that when you contract a certain definite amount of newspaper space, your message must necessarily be limited. If you want to show the relationship between a substantial balance and the service available in your loan department, you may find a little trouble in getting your message inside your fixed newspaper space. Your mailing piece, however, can be

designed as a folder, with the result that the folder can be fitted to the copy.

Before passing from the advertising side of selling personal checking accounts, I want to impress upon you the fact that whether you employ direct mail, newspaper advertising, or both, certain definite arguments are to be constantly kept before your public. In many instances, a definite response will come with the first advertisement; in other cases, the response will follow each repeated message. Your stockholders, directors, employees, and officers will read these advertisements and can arm themselves with selling arguments which they can use effectively upon prospects. The object of advertising is to break down sales resistance and to bring about mental acceptance. The moment a person makes up his mind to use the service of your bank, advertising has fully and completely accomplished its mission.

This is the thought that I should like to register today, for many people believe that advertising must actually sell the particular service or commodity offered. Let me repeat, advertising accomplishes its full and complete mission the moment it brings about mental acceptance on the part of your prospects to use the services of your bank. Actually to sell the services after acceptance has been given, is the job of personal salesmanship.

The sales force of every bank consists of four groups: officers, employees, directors, and stockholders. There are many opportunities for these four groups to sell personal checking accounts.

Your official staff comes in contact with almost every type of cus-

tomers, and while many of the individuals call at the bank seeking services in other departments, a successful officer will find many occasions on which he can recommend a personal checking account to the individual. If the officer will keep in mind the financial requirements of the individual and make his recommendations from the customer's point of view, frequently a new account will follow. To illustrate, many people come into a bank to open a savings account with comparatively large sums of money. In the past they have conducted their financial affairs on a cash basis. What could be more simple and logical than for the officer, in talking with them regarding their savings accounts, to recommend that the deposit be divided up between the savings account, as intended, and a checking account? I dare say that the majority of the officers of our successful banks are already making such recommendations, and many of them are prepared at the time the recommendation is made to show the exact benefits that the customer gets by carrying at all times a substantial balance in a checking account. When such an account is properly sold, it never becomes unprofitable to the bank.

ANALYSIS OF PROSPECTIVE CUSTOMERS FOR CREDIT REQUIREMENTS

In most cases prospective checking accounts should be analyzed for credit requirements before the solicitation is made, for in present-day banking practice, checking accounts and lines of credit go hand in hand. An investigation of the prospect's financial condition should be made in

advance, and it should be brought to the attention of the discount committee, so that the prospect may not have to wait for the line to be approved. All modern banks have an analysis credit file, and this should be enlarged to cover prospective customers as well as present customers.

PERSONAL SALESMANSHIP BY EMPLOYEES

Tellers and contact men have identical opportunities with officers to solicit and secure personal checking accounts, in the course of daily transactions. The tellers especially have a very good opportunity to talk with customers regarding their bank accounts, as they come in contact with many more than the officers do. Employees who do not come in contact with the general public do not have the advantage of soliciting accounts during business hours. There are other ways, however, in which this solicitation can be brought about, and made effective. Employees should be encouraged to solicit business from friends and employees, members of their families, and others, outside of banking hours. Employees' clubs which hold weekly or monthly meetings can be utilized by officers and department heads in showing the employees how to solicit business. New business contests among the members of the bank will promote such education and bring encouragement from officers and department heads.

In present-day banking, new business contests have been tried out with various degrees of success. There are two general classes of new business contests. First is the intensive campaign, usually lasting about ninety days or four months, with team or-

ganization and much pressure brought to bear on the employees in an effort to bring in additional business to the bank. A schedule of awards is agreed upon and paid to the employee at the conclusion of the contest. Many banks have used this method of solicitation, but analysis of accounts secured in this manner shows that much of the business is of a temporary nature and was only placed in the bank on the urgent solicitation of an employee. Second, another form of new business campaign, and one that I believe has many advantages over the one just mentioned, is the continuance plan of award, whereby the employee is paid for his new business effort at all times. There is no intensive driving of employees; it is just a plan where employees who really are "new business minded" can increase their earnings by properly soliciting bank accounts. Analysis of accounts secured by this method shows that they are more substantial and accordingly more profitable to the bank in the long run.

My reason for preferring the continuous plan of awards over the intensive campaign is the experience we have had in the past in our own bank. Several years ago we inaugurated the idea of dividing the bank employees into two or more teams. This method stirred up a great deal of interest in the bank, and the rivalry was very keen. Much business resulted, but as I have just stated, a great deal of this was of a temporary nature, and, at the conclusion of these campaigns, the interest in new business ceased. This situation would continue until such time as we would announce plans for a new campaign and again stimulate the employees with team organization. The result of several of

these campaigns prompted much discussion in our staff meetings, and, after studying new business plans of banks all over the country, we adopted a plan of permanent awards to employees to continue throughout the year; no team organization, no driving of employees, but simply a plan of awards whereby the contestant would receive bonuses on the new business secured.

This plan has been in effect now for almost a year, and the officers are so well pleased with results that plans are under way to continue it indefinitely. Analysis of accounts brought in under this plan shows that they are as a general rule more satisfactory than the ones brought in during the intensive campaigns. I have drifted somewhat from the subject of selling personal checking accounts in my remarks regarding new business contests; however, I feel that employees' contests do have a good deal to do with the subject.

THE NEWCOMER

Another very fertile field for the soliciting of checking accounts is to be found in the newcomers to your city. Many good contacts for your bank can be made by properly soliciting these people. This work should be done by some one in your organization who is well trained along soliciting lines. There is an old saying that first impressions are lasting ones, and that holds very true in bank salesmanship. For the newcomer will judge your bank by the person who first calls on him and by his method of approach.

There are many ways of locating and getting in contact with the newcomer, and the new business depart-

ment of any bank should see that every effort is put forth to call on him as soon as possible after his arrival in your city. In compiling a list of newcomers the daily newspapers should be read carefully, contact should be maintained at the different freight depots, daily calls should be made on the transfer companies, public utilities, and rental agencies, and, above all, your ears should be kept open for conversation regarding new people coming into your city. Even if new business does not result from a call, it is worth something to your bank for the new resident to say, "Those boys from the First National are certainly a live crowd. They called on me and offered me the services of their bank before I had been in town two hours." Such publicity as that will not hurt any bank.

In organizing the different groups in your bank for the soliciting of checking accounts the directors (who are not active officers in the bank) should not be overlooked. In the majority of banks these directors are keenly interested in assisting to bring in new business. The manager of the new business department or the officer in charge of new business should keep in close contact with the directors and encourage them in the soliciting of accounts. This plan, if properly worked, will bring good results. Do not hesitate to call on one of your directors to assist you in landing a prospect. Some people have the idea that the directors of the bank are an indifferent lot, but my experience has been that they are more than glad to assist in any way possible.

What is true of the directors along new business lines is equally true of the stockholders. However, they are usually a more widely scattered

group, but as close contact should be maintained with them as is possible. They, too, will go out of the way to assist in bringing new business to the bank if the matter is brought to their attention properly.

When you are preparing a series of advertisements to be run in the newspapers or a folder to be sent in the mail, send a copy to your stockholders and directors with a letter, and ask that they send in their reaction. In this way you will acquaint them with your new business plans; as a result they will feel that they are really a part of the working organization, and they will be better equipped to solicit business for the bank. To get the maximum results on new business in any bank, the directors and stockholders must be active solicitors.

UNPROFITABLE CHECKING ACCOUNTS

Whenever the average balance in any checking account gets so low that the bank cannot loan any part of it profitably, that account is being carried at a loss to the bank. Every bank in the United States has the unprofitable checking account problem, and one of the reasons for it is that prior to a few years ago, all solicitation for checking accounts failed to set forth the bank's requirement for an initial deposit and a minimum balance. Many of the unprofitable accounts in our banks today were opened prior to the discovery that an account could be unprofitable. There are various ways of changing the unprofitable account into a profitable one. Of course, there must be an increase in balance. The problem of treating the unprofitable account

can be handled both by advertising and by personal contact.

ADVERTISING TO BUILD UP BALANCES

A great many banks have prepared elaborate campaigns for the treatment of unprofitable accounts. Some have been successful; others, not so good. Many of these campaigns have consisted of large newspaper advertisements, run in a series; others have involved the use of form letters; and still others have used printed folders. All of these types of advertising have set out every phase of the question and discussed it thoroughly. This type of advertising has done much to bring to the customer's attention the fact that his account is not always profitable.

But, as I stated before, advertising cannot solve the entire problem. If it paves the way, it has done its duty. Personal contact must convince the customer that the bank's position is correct. Salesmanship of the highest type must be exercised on customers who are of the opinion that the bank is not correct in its attitude that his or her account is not profitable. The person handling this contact should be well informed on costs of handling bank accounts, and should be able to convince the customer that the bank's attitude is correct. A case of this sort improperly handled may easily cause the bank to receive much bad publicity. On the other hand, if it is handled tactfully, an increased balance will probably result.

SERVICE CHARGE

A great many bankers consider the

service charge and the unprofitable checking account problems as identical. As a matter of fact, the service charge is but a part of the unprofitable checking account problem, and is but a means to an end. It may be the solution of the unprofitable checking account problem, but it is not necessarily so.

There are but two justifications for the service charge: (1) to eliminate some of the unprofitable checking accounts (either by increased balance, or by withdrawal); and (2) to bring revenue to the bank.

In every community there are a number of customers who, for various reasons, will not respond to any type of advertising or counsel given in person by a banker, to build up their accounts, unless their low balance is penalized. To reach these people the service charge is justifiable and frequently is necessary. But, again, the installation of the service charge does not eliminate these unprofitable accounts, for it is a characteristic of the American people that they feel that if they pay for a service, they are entitled to its use. Thus, the moment you install the service charge, the individual who has good reasons in his own mind for carrying a low balance, believes that if he pays the charge willingly, he is entitled to carry a low balance, and the experience of banks everywhere is that the charge will not eliminate this type of account. In this case the service charge only makes the account pay a part of its way. Relative to the service charge today, there are over 15,000 banks in 3,000 communities using the service charge. This is approximately 60% of all the banks in the United States.

The charges themselves have a

wide variety of rules, penalties, and exemptions. In some cases the service charge is a real revenue producer, but in most cases the amount collected is negligible. In the majority of cases the charge does not produce ill will. The most common charge among the banks in towns and medium-sized cities is 50c per month on a minimum balance of \$50. In larger cities, the popular charge is a minimum balance of \$100 and a monthly fee of \$1. However, in some cases the minimum balance required is as high as \$250 and the monthly fee from \$2 to \$2.50.

A great many banks are getting away from the flat service charge and are installing what is called a per-item charge. One of the most popular of these charges, and one which has developed after considerable thought and study, is the requirement of a \$100 free balance at all times; for each additional \$100 of free balance the customer can draw ten checks gratis, with a charge of 10c per check when the maximum number for his account has been exceeded in any calendar month. Some banks put in the additional requirement that the minimum charge made against any one customer will be 50c per calendar month. Such a charge as this reaches the commercial customer or the individual who issues a large number of checks each month and fails to carry a supporting balance.

Another method of figuring the service charge is to place the account on an absolute item basis, figuring a charge for every item either deposited to the account or drawn against. Out of town items deposited are analyzed, and collection time, exchange charges, and so forth, are taken into consideration. Then the return on the net

loanable balance is ascertained, and, with these figures at hand, the profit or loss on the account is very easily determined.

CONCLUSION

In conclusion, personal checking accounts will fit in with the selling plan and the new business activities of any bank, regardless of where it is located and regardless of its size. The services that can be performed through a personal checking account are many. Reams of advertising copy can be written around these advantages. Many of them offer excellent material for fine illustrations, for newspaper advertising, printed folders, and small booklets. The whole plan of selling personal checking accounts can be made to lead directly to other profitable and desirable business for any bank.

Too much stress cannot be placed upon the proper use of both advertising and personal salesmanship in the building up of profitable business for your bank, and the same two weapons can be used in the education of your unprofitable customers along the lines of building up their accounts to a paying basis. The service charge on accounts is an economic change in bank operation, and I am of the opinion that within a comparatively short time the banks over the entire country will solve this great question to the satisfaction of both the customer and the bank.

Discussion

R. L. WHITESIDE (American National Bank, Denver): Which of the two service charges do you prefer, the minimum balance or per-item?

MR. CARSON: I prefer the per-item basis because I believe the burden should be placed where it is incurred. I do not think profitable accounts should be made to carry the unprofitable. I think the per-item charge is the basis that will eventually be installed all over the country.

ALMA SCHULZ (Hudson County National Bank, Jersey City): In your employees' contests, do you think it better to have an employee go after what you would consider a profitable account or have him recommend the account to the new business man?

MR. CARSON: In most cases I would say it would be better for the employee to turn in the name and state what preliminary work had been done. In many cases, however, I have seen the employee go through with the entire solicitation. In such a case, we look upon that employee as "new business minded" and give him recognition. Some of the most profitable business may come through an employee. I think with the larger lines, especially where credit is involved, the proper way to handle them is for the officers of the bank to carry on the work after the employee has brought in or suggested the account.

MISS SCHULZ: Do you ever ask customers to recommend accounts to you?

MR. CARSON: Very often. Customers of your bank are one of the best advertisements you have. If you have satisfied customers they can bring you more business than you can possibly get by any kind of sales organization or advertising campaign. Satisfied customers are the backbone of almost any banking organization.

JAMES WEIR (Stamford Trust Company, Stamford, Connecticut): We have just installed a service

charge in our bank and it is figured on a basis a little different from any of the plans I have heard discussed here. We charge fifty cents a month as a minimum charge. An account carrying from one dollar to ninety-nine dollars pays fifty cents and is allowed five checks free. Each check over that costs five cents per item. In an account from \$100 to \$199, fifteen checks are allowed free, with a charge of five cents per item after that. In an account from \$200 to \$299, twenty-five items are free, and items after that are charged five cents apiece. If the account carries a maximum balance of \$300, there is no service charge at all. Do you favor a plan of that sort?

MR. CARSON: I think that plan is a good one. You are placing the burden where it is incurred, on the unprofitable account, and that is the point I tried to make.

JOHN M. GORDON: (Security First National Bank, Los Angeles): Owing to the antagonism created by service charges, I have been thinking for some time of having some sort of campaign of education to convince the customers of the benefits they will derive from carrying a larger balance, rather than trying to convince them that the bank is losing money, because most of them think the bank is making too much money, as it is. But my idea is to educate them to see the advantage to them which will repay them for the sacrifice they might make to carry a larger account.

MR. CARSON: I believe the education of your customers along the line of carrying profitable accounts will be the greater part of the solution of the problem of the unprofitable account.

MISS CECILIA KIEL (Mercantile

Commerce Bank, St. Louis): Do you know whether any of the banks in the United States have experimented with the attempt to develop new business through organizations? I thought this was in line with the question that was just asked in regard to educational work. I have in mind addressing clubs, or alumni associations, nurses' guilds, or other organizations of that kind. Has any bank that you know of experimented along that line? Do you think that is worth while as a means of approach?

MR. CARSON: I believe that publicity, properly worked out, and having speakers go among the various clubs to make talks, would do a great deal toward helping any bank. However, there is no direct benefit. That comes under the general head of direct advertising for new business.

I think several banks over the country are doing that. I know the banks in Little Rock send speakers to these different organizations and try to encourage them along the line of thrift and other things in which they might be interested. Does that answer your question?

MISS KIEL: I was trying to adhere to the checking account idea rather than the thrift idea, that is, educating women, for the most part, to the proper use of checking accounts, through organizations they might belong to. I think women usually have more confidence in anything that comes to them through an organization with which they are already affiliated and which they trust. I think they are more easily approached, perhaps, in that way than they would be through either advertising or direct personal salesmanship, as a beginning, of course.

For instance, take a group of

nurses. They do not have a great deal of commercial contact, that is, direct contact with the business world. A solicitor from the bank could address one of their meetings and educate them along the line of the proper use of a checking account, pointing out the difference between a profitable and an unprofitable account, and teaching them the proper use of the whole organization of a bank.

That is what I am trying to find out, whether any of the banks are doing that and if they have found it valuable and worth while.

MR. CARSON: I think a plan like that would do a great deal toward bringing about a better understanding among organizations and bodies of that kind, but looking at it from a strictly profitable standpoint, it would hardly pay because often these organizations are made up either of young men or young women whose business is not profitable for the bank. I tried to make my discussion deal with profitable business as much as possible.

LEE SMITH (Exchange National Bank, Tulsa): Mr. Carson, in making your analysis of accounts which seem to be unprofitable, do you take into consideration the number of items or the amount of service that your customer is asking your collection department to render gratis?

MR. CARSON: Yes; in the analysis work we have been doing recently in our bank we take each account and charge everything to it. We charge each individual check that is deposited in the bank. If it is drawn on a four-day point, we charge the account four days outstanding on the check. If the customer has collection business, we charge that also. We charge the time of the teller, the book-

keeper, the officers, and rent, heat, light, water, and so on. We find that a great many of our accounts that we thought were profitable, on making this analysis prove to be very much the contrary, very unprofitable.

OSCAR DYKES (Hamilton National Bank, Chattanooga): Just as a matter of information—we have a service charge of fifty cents a month on an average balance of \$100. The first of August we are going to make a new service charge of one dollar on an average balance of \$100 and accounts that have checks amounting to more than twenty dollars will be charged five cents per check.

The question I want to ask is this: what system do you use in making these service charges at the end of the month? Do you let the bookkeepers handle this or does some junior officer assist in this work?

MR. CARSON: Some one else takes the bookkeepers' ledgers and checks them over. We have a fifty cents per month service charge, too. It applies only to the small accounts. All of the larger accounts in our bank are on the per-item analysis basis and we are actually making charges for unprofitable accounts at this time and really collecting the money. The tellers take the books and make the service charges themselves.

CHARLES A. WILLIAMSON (Bank of Commerce, Charleston, West Virginia): As some one has said, banking involves reciprocal relationship. The acceptance of an account involves the obligation to loan money. I presume that is the reason banks in general have been a little more backward than ordinary lines of business in going out for business. I would like to know, therefore, what method you use to get credit information on

any prospective customer, so that you would know that your side of the obligation might be reasonably profitable.

MR. CARSON: When we have a prospect whom we are trying to get for a customer and presume he is going to want a credit line, we get a Dun or Bradstreet report and also write letters to our friends and correspondents in other places where the customer may have been acquainted and get as much of a line on him as possible; we make a credit file for him, which we place in our credit file for ordinary prospects, but showing that he is not a customer. The discount committee looks over these reports, and if the man actually comes into the bank, it reduces the time he has to wait to know whether or not his credit line has been approved.

PHILIP H. BUTTERFIELD (First National Bank, Concord, New Hampshire): I should like to ask Mr. Carson if he thinks a bank or group of banks contemplating a service charge should advertise the fact in the newspapers.

MR. CARSON: Yes, I think by all means, when either a bank or clearing house or whatever organization it is, contemplates putting in a service charge, the customers should be well informed beforehand because education along these lines is the only way a bank can ever break down the idea that a bank doesn't always make money. The more you have your customers educated to the fact that accounts can be unprofitable, the less work you will have to do in discussing it with them when they come into the bank to talk about their accounts. That will relieve some of the personal contact work, because often customers think they are carrying a profitable account when they are not, at all.

If you will place the information before them in the newspapers in such a way that they will read it, they will begin thinking about it themselves and when you do have to convince them, you will find it easier than if you blazed out in the newspapers that you were inaugurating a service charge effective June 30. If you have a campaign of advertising beforehand, I think it relieves the situation a good deal.

MR. BUTTERFIELD: I am thinking of the difference between advertising in the newspapers and direct letters, that is, whether it is better to notify the general public through the newspaper or just the customers of the bank by letter.

MR. CARSON: Your first allegiance should be to your customers, but you cannot always reach all of your customers because the mailing list is not always up to date. I think it would be advisable to send a letter to the customers from the central file mailing list, but the best medium is through the press.

MISS MARION MATTSON (Northwestern National Bank, Minneapolis): I should like to ask if you pay interest on any of your profitable accounts.

MR. CARSON: The Little Rock Clearing House does not permit the payment of interest on any checking account. We pay 4% on savings accounts but nothing on checking accounts.

HARRY L. GRAY (Cambridge Trust Company, Philadelphia): I should like to ask if you change your per-item cost, that is, the rate on different accounts. For instance, we have some accounts that have a great number of checks which we can handle more cheaply than an account

that has a few items. Do you have a varying rate or a fixed rate?

MR. CARSON: We have arrived at the amount it costs to accept a deposit over the window and put a check through for collection, and so forth. The only way to handle this is to place a charge on each item handled. This is only an experiment with us, of course. At present, this is the best method we have found. No doubt we will find things wrong with it as we go along, but we are trying to make each account pay its own way. We have a fixed rate.

CARL E. LINDQUIST (Puget Sound Broadway Bank, Tacoma): I dislike to appear so often, but I should like to show you one of the dangers of solicitation of accounts. The day before I left for the convention I happened to be in another bank. The president of the bank happened to see me and called me to his desk. He said, "I want to tell you something about an account we have. We have just analyzed it and we find it is costing us \$100 a month. We asked the customer to come into the bank and either increase his balance to compensate us for that \$100, or else we will make a charge." The president of this bank would not mislead me about this question, and he told me the concern would not carry enough and they would have to put the charge through. He said, "You can have the account if you want it."

We wouldn't want an account that would cost us \$100 a month. It shows that unless you know something about what the concern's account is in the competing bank, there is a good chance of your taking on a liability you will have to explain a little later under more difficult circumstances.

MR. CARSON: In our local clearing house we have an exchange of local credit information so that if one bank wants to find out the financial standing of a customer of another bank, it is allowed to ask for credit information from the secretary and the information is given.

MR. LINDQUIST: Would you be able to get the cost of handling an account through that source?

MR. CARSON: Yes, if the account was on the analysis list.

R. B. RATHBUN (First National Bank, Minneapolis): In connection with the study of service charges, have you known of any case in which a graduated charge is made in accounts with minimum balances of \$100, \$200, and \$300? I ask that question for the reason that I believe we ought to agree on one or two things in service charges. The first is that the average commercial account does not pay its own way unless it reaches approximately \$300. The second is that basically there is some injustice in the present and usual plan of service charge in that under this plan a man whose balance is \$99 will be charged, whereas a man who carries an account with a balance of \$101 will not be charged.

In Minnesota we have been studying for the last six months the possibility of installing a graduated charge, charging perhaps one dollar and a half on the account that averages less than \$100, perhaps one dollar on the account that averages between \$100 and \$200, and perhaps seventy-five cents or fifty cents on an account that runs from \$200 to \$300.

Do you know of any instance where such a plan or any similar plan has been installed and is in use?

MR. CARSON: Mr. Weir of Stam-

ford, Connecticut, explained a few moments ago that his bank had a graduated scale similar to the one you outlined.

MR. LINDQUIST: Quite a number of the banks in the Pacific Northwest have this "metered" service charge, as they call it, and more banks are coming to it all the time. They charge four cents an item instead of five, and they analyze the account and make it a clearing house proposition. Every one stays with it in that way and it has made quite a difference in the earnings of the banks.

MR. RATHBUN: You mean they charge by item and not by balance?

MR. LINDQUIST: Yes, and take into consideration the average balance and deduct the cost of handling the

account. They charge four cents an item for out of town items and two cents for clearing house items.

DOLLY HENDERSON (First National Bank, St. Paul): Do you have any provision for the elimination of the service charge if the customer has a good sized savings account or a certificate of deposit?

MR. CARSON: No, we have not. We contend that when we pay four per cent on savings accounts and certificates of deposit, we are paying all the money is worth and if they are carrying checking accounts, they are charged the service charge. The only exception we make is that of omitting the charge on accounts of lodges, churches, missionary societies, and organizations of a charitable nature.

Filing Systems for New Business Use

By EARL V. NEWTON

ASSISTANT SECRETARY OF THE CLEVELAND TRUST COMPANY, CLEVELAND, OHIO

Address before the Denver Departmental Conference

In Mr. Newton's discussion of Filing Systems for New Business Use, he makes excellent application of a survey made by a committee of the Financial Advertisers Association. This committee, of which Mr. Newton was chairman, had expected to work out a standard of practice for central file operation; but they found that this was impossible, because of the many different uses to which a central file may be put. The committee did, however, work out the following principles:

1. In installing a file, the experience of companies making a specialty of filing equipment should be given first consideration.
2. The installation of a file should be preceded by a careful survey of the uses to which it is to be put under each bank's own peculiar conditions.
3. The average unit cost of operation, covering cards, files, and overhead, is about $7\frac{1}{2}$ c per card.
4. Most of the faults of the central file are human ones that can be corrected by intelligent supervision.
5. The most successful files in existence at the present time are those built as an aid to the banking department.

For the benefit of those representing larger institutions, Mr. Newton discusses in detail the experience of The Cleveland Trust Company, in building separate central and new business files, touching mainly on the handling of new business records.

DURING the past few years the feeling has arisen that a central file and a new business file are one and the same thing. This has been brought about largely because of the activity of certain manufacturers of filing equipment, and the wide publicity that the question has been given. As a matter of fact, the combining of the two files is confined mainly to smaller institutions where the prospect list is limited.

In my own institution, The Cleve-

land Trust Company, we find it necessary to operate two separate records. Our central file contains more than 1,500,000 cards, and we have approximately 50,000 cards in our new business files. This means that we have about thirty central file cards for each one of our prospects. You can readily see from this that it would be foolish to attempt to carry our new business record on the cards of our central file. In the first place, our central file cards are only 3" x 5"

in size, and that does not allow sufficient room for new business information and a record of calls. Secondly, our comparatively few new business cards would become lost when thrown in with the greater number of central file cards, making it difficult to work over our new business records and search for leads. On the other hand, a bank with a central file of 25,000 or 50,000 cards could easily carry its new business record in a file of that proportion.

SURVEY OF CENTRAL FILE PRACTICES

Two years ago I was chairman of a committee of the Financial Advertisers Association that conducted a survey of central file practices among the banks represented in that organization. Out of 240 replies to a questionnaire studied by the committee, more than 70% indicated that the banks did not include their new business record as part of their central file.

I realize that my audience here this afternoon is made up of two distinct groups:

1. Those who are from smaller institutions, where a combined central and new business file would be entirely practical
2. Those who represent larger banks, where separate files are, or should be, maintained.

For that reason I am going to divide my talk at this point into two parts, and tell one group about some of the high spots of the central file study that was made for the Financial Advertisers Association. To the other group, representing the larger institutions, I want to give the benefit of our experience at The Cleveland

Trust Company, in building separate central and new business files, touching mainly on the handling of our new business records.

In making the central file study for the Financial Advertisers Association, the committee started out with the idea that its work might result in a standard of practice for central file operation that could be adopted by all banks. We soon found, however, that this was not possible, because of the vast difference in size and type of our banks, and of the many different uses to which a file has to be put. As I said before, we studied more than 240 replies in the course of this survey. Here are a few of the high spots:

In installing a file, the experience of companies making a specialty of filing equipment should be given first consideration. Replies were almost two to one in favor of the equipment purchased from specialty companies over that supplied by the local printer.

DETERMINE FIRST THE PURPOSES OF THE CENTRAL FILE

The first question that a bank must decide before it undertakes the organization of the central file is just what it wants its central file to accomplish. After that is settled, the question of size of card should be given serious thought. This decision will be governed largely by the size of the bank, the number of its departments, and the amount of information that will be placed on the card. A combined central and new business card naturally will have to be much larger than one that is used exclusively for a central file record. For a small bank, a 3" x 5" card seems to be the popular size; for

larger institutions, 6" x 8" in size was given preference. Our survey showed that card sizes range from 2½" x 3½" up to 8" x 11". Out of all reports received, a 5" x 8" card seemed to be the most popular, and 4" x 6" a close second.

TWO METHODS OF FILING CARDS

There are two methods by which central cards may be filed: either vertically (blind), or horizontally (visible). All of you are familiar with the blind method. The visible method has come into use in recent years. The cards, under this system, are laid flat and hinged in shallow trays, with the bottom lines of each card exposed so that any name can be located instantly. The visible system, however, is much more expensive than the vertical, and this feature accounted perhaps for a vote of more than three to one in favor of the blind method by those banks reporting on this question.

Banks operating central files are using them for more than a general index. This was indicated from replies to a question asking whether more than the name, address, business connection, and services used, were shown on the central file cards. The amount of information that should go on the card can be gauged only by the size and the actual number of departments of the bank, and the particular job that the file is going to be called upon to render.

COST OF THE CENTRAL FILE

All of you of course are interested in what a file is going to cost. In analyzing the cost figures shown in our replies, we found that the average

unit cost of operation covering cards, files, and overhead, was about 7½¢ per card. This figure was further borne out when it was shown that the average cost a year per thousand cards was \$71.19.

Replies indicated that an operator can handle anywhere from 1,000 to 104,000 cards. This wide difference in the number may be attributed to the fact that in some central file departments, clerks work exclusively on cards; and in others, they make up new business reports and do other typing work in connection with their regular central file duties. The average of all of the replies received, indicated that one girl working alone should be able to handle a file of approximately 24,000 cards.

Most banks regard the central file as an adjunct to their banking departments. Out of all of the replies received, 75% charged their operation to the banking department, 18% to new business, and only about 7% to advertising. In a bank having one of the largest central files in the country, the central file is regarded entirely as a part of the banking department. One girl at the files, however, spends all of her time on new business work, and her salary is borne by the new business department.

MERITS AND DEFECTS OF THE CENTRAL FILE

In analyzing the replies sent in, it was interesting to note that the chief complaint against the central file concerned the inability to keep it 100% correct at all times. The correctness of customers' addresses came in for the lion's share of the criticism. In this connection, I have never yet seen a city directory or telephone

book that was entirely correct when it was distributed. A very large proportion of the population of all of our large cities is constantly "on the move." People are never in a hurry to report their changes of address. It has been our experience that 10% of all mail sent out to a new list will be returned because of incorrect address. Comparatively little of the trouble, however, lies with the customer. If the bank will provide the necessary machinery, its central file clerks can easily see that every department affected receives notice of each change of address. There is no reason why the information should not be kept correct. Most central file errors can be eliminated with the proper system and supervision.

In making this central file study the committee asked users to give an opinion of their files, whether the cost was warranted, and what they considered to be the greatest defect. In practically every case the reply was that the cost of operation of the file was entirely warranted; that a central file was invaluable to a bank's operation; and that its chief faults were human ones that could be corrected. The committee, in concluding its report, called attention to five points that should be given consideration by any bank planning the installation of a central file:

1. The central file in ninety-eight out of a hundred cases has proved its worth and has come to be regarded quite generally as a necessary tool in bank operation and development.
2. The purchase and installation of a file should be preceded by a careful survey of the uses to which it is to be put under each bank's own peculiar conditions.
3. Most of its faults are human ones that can be corrected by intelligent supervision. Eternal vigilance and strict attention to detail and accuracy is the price that must be paid for a successful file.
4. Simplicity also has its reward. A card designed with a few features is much better than one that is so overloaded that it cannot be used efficiently.
5. The most successful files in existence at the present time are those built as an aid to the banking department. The central file has a place in development and advertising work but cannot be entirely justified on that basis alone.

NEW BUSINESS FILES OF THE CLEVELAND TRUST COMPANY

And now I want to tell you a little about how we operate our new business files at The Cleveland Trust Company. Our bank has more than 450,000 accounts, and our central file, as I told you before, contains more than 1,500,000 cards. For that reason our two files are operated entirely separately, the new business department's only contact with the central file being a girl who spends all of her time searching, checking records, and digging up information for us. Our new business record card measures ten inches wide, and seven inches high. It has space across the top of the card for the name and local address, and out of town address, if there be any. All officers and directors are listed, and opposite each name we show the services of the bank which they personally use, and also, if they have any official connec-

tion with any other bank. In the lower right hand corner there is a space showing all of the services of the bank that are used by the subject company or individual, as the case may be. Space is also provided for showing club, church, or social affiliations in the case of the individual, other banking connections, capital, rating, and so forth. The back of the card is used for noting calls, and other information.

We do not confine our use of this card to the prospects alone, but also use it for customers, believing that the bank's customers represent its best avenue for new business. I should say that at least 25% of the cards in our new business files are those bearing the names of our present customers. Too many banks pay considerable attention to getting the new account, but very little to keeping it. However, this part of my paper has to do with the building of a file, and I will go into the question of customer cultivation later on.

SOURCES FOR NAMES OF PROSPECTS

There are several different sources from which names may be secured for a prospect file. In the case of the starting of a new business department record, the first step should be to place on cards the names of all customers carrying substantial balances, and the services used by them. Additional names can be added from day to day as new accounts are opened, or names secured. We are continually checking corporation and city directories, and periodically go over the classified section of our telephone book for new names.

When a new name is discovered,

it is placed on what is called a "work sheet," which is a mimeographed 8½" x 11" form, showing the name and address, and the officers and directors and affiliations in the case of a corporation. This sheet, which is written in pencil, goes to our central file, where a check is made to determine whether we have any business with the individual or company, and, in the case of a company, with any of the officers or directors, or with any of the companies with which they in turn may be associated. When the work sheet comes back from the central file with the information properly supplied, all of it is typed on our new business card and becomes a part of our permanent record.

In checking over the names of the officers and directors of the company, we have found that the information regarding their affiliations with other companies is of great value, and we have therefore developed as part of our new business records an affiliation file. The cards making up this file, which, of course, contains only the names of the individuals, are 5" x 8" in size. Across the top there is space for the individual's name and address, and the personal service which he uses. Below are shown his business affiliations. In the building of an affiliation record, much of the information will have to be added to the files over a period of time, although a great deal of it can be secured from corporation directories, and other sources.

CREDIT EXTENSION

If it happens to be a company that we are working on, one that is unknown to us, and one which is likely to require credit extension, we se-

cure an agency report, and, if possible, a financial statement and other information regarding the company. All of these data are then sent to an officer of the bank, who either approves or disapproves the item for solicitation. If he disapproves, it is tickled for six months or a year, when it will again be brought to his attention, after we have secured new and up to date information.

In the case of approval, the item is immediately assigned to an officer or a member of the new business staff. The form used in making this assignment consists of a duplicate set of 3" x 5" slips. The original is white, and the copy is golden. When the typist is ready to make an assignment, she slips a narrow strip of carbon between the two forms, so that copy impression will be made only on the first two or three lines of typing. This permits the typing of information of value to the solicitor on the original or assignment slip without its appearing on the copy. The name and address of the company or individual, the date, and the name of the solicitor appear at the top of both.

The new business card containing all the information that has been secured, as well as the agency report, financial statement, officers' comments, and other data, goes to the solicitor with the assignment, to aid him in making his initial call. The copy of the assignment is retained in what we call our "call record file" until a report of the call is made by the representative. When this has been done, a complete report is typed on the back of our new business card, and the date of the call placed on the assignment copy or record slip, which is then filed away in its alphabetical position.

In reporting a call, the solicitor in most cases will tickle the name for the future, the time ranging from ten days to six months. When this is done, we make use of two other slips, the first of which is blue in color; on this we place the date upon which the solicitor expects to make his next call on the prospect. This slip, containing the tickle date, together with a copy which is used as a tickle follow-up, is placed in the customary tickler file with which you are all familiar. When the tickle date arrives, the tickle slip goes to the one for whom it is intended, and the copy goes to the new business manager to aid him in seeing that the item is properly followed. If the solicitor, in making his original report, does not eliminate the name as a prospect, and fails to place a new tickle date upon it, the item is automatically tickled for one year by the record clerk. This is done so that no names will ever be lost in the file, every live one coming up for attention at least once every twelve months.

ZONING THE SOLICITORS

Some of you may operate branches, and, if so, will be interested in the way our solicitors are zoned. We have in the department four outside representatives who devote their time to commercial and savings solicitation, working almost entirely by assignment. Each representative has a certain group of our fifty-eight branch offices, and, as new leads are secured, the assignments to these solicitors are made in accordance with the zone arrangement. From time to time we make business house surveys of each branch's territory, calling on all stores, factories, and offices in a given dis-

trict. As these calls are made, they are recorded on 4" x 6" white cards, which are filed alphabetically by zones. The only exception to this procedure is in the case of a manufacturing company for which we already have a large new business card. In this case, the white zone card simply carries a cross reference to the new business card.

As I have said before, we are paying almost as much attention to our present customers as we do to prospects. In the upper right hand corner of our new business card we have provided space for showing the monthly average balances of our better commercial accounts. We carry these only on accounts averaging \$2,000 or over, the figures being secured from the interest slips which are computed at the end of each month and forwarded to the new business department. With this information regarding all of our accounts in our new business files, it is a comparatively simple matter to classify and follow these, so that proper contact is maintained with the owners of all of our big accounts at all times. This we accomplish by classifying to a certain extent all of our accounts, assigning the accounts with larger balances to officers, and, in some cases, to branch managers. Many of the calls made by the representatives in the new business department are upon present customers carrying substantial balances. We also make a practice of assigning every week a certain number of calls to each of our branch managers and in turn expect from them a report on the calls that they have made. Through the officers, the managers, and the department representatives, we are able to keep in touch with all our good accounts.

In order that the relationship of subsidiary companies or merged organizations may be indicated in our records, we place such related blue record cards together in a folder bearing the name of the parent company. So that all cards thus filed may be readily located, a yellow cross-reference card is made out in the name of the subsidiary company, and filed in its proper alphabetical place.

NEWSPAPERS AS SOURCES OF INFORMATION

It has been our experience that newspapers, carefully checked, furnish us with important current information concerning activities and corporate changes that are of much value to us in keeping our files up to date. Reports of annual meetings, changes in directorates, officers, and business policies, merger reports, and so forth, are clipped from newspapers and other sources. Any necessary changes are made on our records, and the clipping then pasted in a clipping folder, which is placed with the blue record card of the subject company, and put into the files in a folder.

Whenever any card or folder is removed from the files, the clerk places in its stead a pink index card headed "card out," on which she notes in pencil the name of the blue record card withdrawn, the date removed, and upon whose request. By this practice we are able to eliminate the possibility of cards becoming lost from the files, and to trace all cards not promptly returned.

The building of a new business file is a matter of simple detail. However, it is one thing to build a file and another thing to operate it. All of which reminds me that seven or

eight years ago, during the epidemic of banking promotion companies, scores of good institutions purchased thousands of dollars' worth of folders and other advertising material, which was paid for and then promptly stored in the stock-room until some one should work up a prospect list and mail out the material. I have a hunch that some of the same material is still reposing where it was first stored. Unmailed advertising material will not build good will or increase deposits any more quickly than a perfect central or prospect file that is not being operated. If you do not happen to have solicitors employed by your bank, draft a few of your officers and interest them in selling the services that your bank has to offer.

What I have told you regarding the operation of the prospect file at our bank may not fit into your particular problem at all. If you are from a bank of the average size operating a single office, perhaps all you will require is a small file operated simply, but one which will grow as your bank grows. However, every institution has some problem that is its very own, and I hope that from some of the things that I have told you of the operation of our new business file, or from our central file study, you have gained an idea that may be helpful to you.

Discussion

HARRY A. DAVIS (United States National Bank, Portland, Oregon): What do you do with any correspondence you might have?

MR. NEWTON: That goes in the general file.

MR. DAVIS: You might have a stack of correspondence over a period

of five years. When an officer is conducting this correspondence, and the letter to be written depends, as letters usually do, on the previous letters that have been written or the answers thereto, does that officer have to go to the general file to get those?

MR. NEWTON: Yes.

EDWIN P. NEILAN (Houston Land & Trust Company, Houston): Mr. Newton, you made the statement that the visible record is more expensive. You meant that the initial cost is greater, didn't you?

MR. NEWTON: I think the initial cost is more.

MR. NEILAN: The reason I asked is that after struggling for ten years with a vertical file, we installed an Acme, large system, central information file. Before we installed the file, we surveyed the expense and the time incident to handling the old vertical file and came to the conclusion that, although the initial cost was about three times greater than the cost of the vertical file, the handling charge would more than offset that over a period of years.

MR. NEWTON: How many cards are there in your file?

MR. NEILAN: About 25,000.

MR. NEWTON: I should say for a file of that size the visible file would be fine, but with a million and a half cards, such as we have, it would be difficult.

JEFFERSON C. CHAPPELL (First National Bank, Atlanta, Georgia): In making a call on commercial prospects, do you have each name approved by an officer of the bank?

MR. NEWTON: I am glad you asked that question. I should like to get some opinions from the rest of you as to what you do in your banks. That is a very much discussed ques-

tion in our bank just now. The four men we have in the department work largely by assignment, but the question is, if a man goes out and sees a new store going into a certain location, should he make a cold call, soliciting the account without first finding out about the people? Our camp is divided, one group being of the opinion that it is not necessary, claiming that if the solicitor has credit sense, he can go ahead, and if he hasn't, he should get out of the work as quickly as he can.

I should like to hear discussion as to what your banks do in that regard.

MR. NEILAN: For two years I have worked on what might be called a cold list, a proposition like that. I have found that it saves embarrassment in a good many cases to get what information is possible regarding the credit rating of the prospect and also the habits and attitude of the firm or person toward our bank and other banks in town before you tackle them for the account. When I started I was very green at the game and walked into several establishments where I was rather embarrassed before I left.

MR. NEWTON: I think it takes certain credit sense. These men I am using now have been with us five or six years and they have got so that they know when they go into a store and a man starts talking credit, whether he is the type of account we want. Once in a while we come across a case where the solicitor is asked to bring in a statement and when it is brought in, the account has to be refused, but those cases are few and far between.

If we stop to make a check on the prospect and make up a file on every name we call on, one man

could probably handle all the calls we would make. We want credit accounts, but the question is, if a man goes down the street and sees a new store, shall he get a financial statement first or make the call and not run the chance of his competitor's getting the account while he is doing that?

MR. DAVIS: We work on the theory, first call and get acquainted. The matter of credit is never talked on the first call, nor is the solicitation of the account made very direct or appealing. It is just to get the information and we make our new business call as much of a credit call as we can. That memorandum of our call is sent to our credit department in all cases. We think that is the safest way. If we wait to get a report from the credit departments of business houses, and so forth, we often find that the other banks have gotten there ahead of us.

CECILIA KIEL (Mercantile Commerce Bank, St. Louis): How closely do you work with the credit department, and do you have any method of getting before the solicitors any information that might offer any aid from the credit files?

MR. NEWTON: We always make a check on that with a company of any size. We get from our credit file any information we have on them.

MISS KIEL: Before the solicitor makes the call?

MR. NEWTON: Oh, yes. Whenever it is possible to get the information, that check is made. We work on the list of new corporations every day; it is not possible, of course, to get files on those because there are no files in existence. On such a prospect the solicitor has to go out cold, but he has to use his own judgment

and eliminate the prospects that do not look good.

FREEMAN STRICKLAND (First National Bank, Atlanta): Do you have a way to mark the cards in your file as to the nature of the prospect?

MR. NEWTON: We carry very few savings prospects in this file, except on this four-by-six card in one of our branches.

MR. STRICKLAND: How many names do you have in your central file?

MR. NEWTON: We have a million and a half in our central file.

MR. STRICKLAND: How many names do you have in your prospect file?

MR. NEWTON: About sixty thousand.

MR. STRICKLAND: What per cent of those do you consider active?

MR. NEWTON: They are all active. We eliminate a great many, and I should say fifty or sixty thousand are active. Some of those are ticklered for a year; some we never get at all. Out of the sixty thousand I should say five per cent were live prospects.

MR. HALSETT (First National Bank, Chicago): How often do you go through your files?

MR. NEWTON: We are working on them all the time. We have one girl constantly going through the files, taking out those that have been ticklered for a year and deciding whether additional calls should be made, or taking out those that should have been ticklered and marked sixty or ninety days but somehow slipped through, if in the meantime the firm has gone out of business.

R. B. RATHBUN (First National Bank, Minneapolis): Do you have any definite number of calls for your

senior and junior officers to make on customers or prospects?

MR. STRICKLAND: We have tried to work out a system whereby all of the officers in the bank are given a certain number of customers to call on periodically. The slips that are sent to the officers each week are supposed to come up that week and the officers are questioned and reports are made on them.

MR. NEWTON: Francis Ansley, you are successful in getting your officers out to make calls; tell us how you do it.

FRANCIS M. ANSLEY (Guardian Trust Company, Cleveland): Of course, you have difficulty in getting certain of the officers, particularly the main contact men, out on calls because the time of those men is so taken up with interviews with customers, it is almost impossible to get them away from their desks. If you will segregate your officers into two groups, one group being the active contact group and the other more or less the free lance group, you will have little difficulty getting out the free lance group to call on customers, or on prospects.

MR. HALSETT: Who passes on the names, your loan officers?

MR. NEWTON: If the account requires a line of credit in advance, it is taken to the discount committee. A great many are cold calls, where nobody has passed on them until after the call has been made. With the larger companies, where we think there is a line of credit involved, the solicitor gets an okeh before he goes out. However, we make several hundred calls a month without getting an okeh in advance. The solicitors have been at it long enough to know an account that looks good.

How to Select Trust Prospects

By J. M. EASTON

ADVERTISING MANAGER OF THE NORTHERN TRUST COMPANY,
CHICAGO, ILLINOIS

Address before the Denver Departmental Conference

A list of names is not a list of prospects. It may turn out to be a list of suspects. Mr. Easton offers the following suggestions for the solicitation of logical prospects:

1. Build up your lists carefully.
2. Do not add names to your list until they have been properly evaluated.
3. Be sure that your solicitor immediately gets his fingers on the financial pulse of the inquirer.
4. If you are after the higher unit of sale, you will have more suspects than those interested in a lower minimum of wealth.
5. Be on the lookout constantly for new names.
6. Keep up your "dead file" and make constant use of it in checking prospects.

WE are gathered together today from all corners of the United States to discuss our common problems, and to exchange ideas on various subjects. And there are plenty of ideas to exchange on the general subject of banking; even more, regarding the trust end of the business. There are many sides to the solicitation of trust prospects and to the securing of logical prospects for the services of the trust company. In the business itself, there are differences of opinion as to the effectiveness of different media for securing names and inquiries from the individuals. The methods of solicitation are many and varied, so that what is good for one company is not considered at all by another.

The vigorous solicitation of trust business is of fairly recent origin. True, some trust companies for several years past have gone after business in

a systematic, forward way through modern selling methods. For the wide majority of companies, vigorous modern methods have been introduced during the past four years. Many trust companies are only now organizing themselves for securing business by active, systematic solicitation of prospects.

The subject assigned to me today is the fairly elemental but highly important one of the trust prospect; how to secure him, and, once he is secured, how to determine whether or not he is a prospect. The original assignment made me was How to Separate the Suspects from the Prospects. Now I discover the subject is to be How to Select Trust Prospects. The subject matters little, however, as we will announce it and depart from it immediately. You may wish before the hour is up that I had used the subject sooner as a terminal.

WHAT IS A PROSPECT?

In the first place what is a prospect? Is every man or woman of means a prospect? Is every name in your trust prospect file that of a prospect, or is a prospect a man or woman who has actually indicated an interest in your services and has the means to qualify him or her for those services?

Let us look first at a metropolitan area like Chicago. Is every person in my city a potential prospect? No; we know that only a small percentage of the population represents the stratum of prospects. Another small percentage is made up of potential prospects. Here are some of them:

1. Young men and women just making their way in business and profession

2. Men and women of humble origin, who, by dint of hard labor, have accumulated large or modest fortunes

3. Men of means or executives of high earning capacity who have recently moved to the city

4. People who have recently come into money through inheritance or the sale of property or business interests

5. Persons established socially by virtue of their wealth or talent

6. Persons of means who are neither socially inclined nor ambitious

7. Professional men and women

8. Men of large salaries, but socially obscure.

These are the prospects or persons we want. How are we going to select them from the population of our towns and cities?

SOURCES OF PROSPECT LISTS

The first step is to secure the names of depositors with substantial bal-

ances. This type is your best source. But it is sometimes misleading, for often your best prospects may operate on low bank balances. A Boston bank has told me that so far it has found the most likely prospects, not among those with \$5,000 and \$10,000 balances, but among those of \$1,000 to \$2,000. If you make a list of your best depositors, be sure that those with the largest average balances go the rounds of your major executive officers, so that they may be checked for points of personal contact and other helpful information. This checking by bank officers often prevents the jeopardizing of a good bank account by an untimely call. One New York bank solicits bank customers rather exclusively. It has an almost unlimited field among these customers, so large is the bank. But no call is made by a salesman without first obtaining a letter of introduction from the officer who knows the prospect. First, of course, check these names against your trust customer list.

There are various other sources of prospect lists:

1. Names secured from club directories, telephone and professional directories, credit files, and financial rating books

2. Officers of all corporations which have a certain minimum capitalization

3. Bond and vault customers of your bank

All customers of your bank can be evaluated as prospects if you will study their business and professional connections, records of securities purchased, taxes paid, and balances maintained.

4. Names suggested by your own officers, directors, stockholders, cus-

tomers, and employees; by attorneys, insurance underwriters, and accountants

5. The persons in your community who stand well as substantial citizens.

Let us assume then that our central file trust prospect list now contains the names of men and women of known means, people of position, persons whose wills, trust agreements, and agency accounts we should like to have.

But these are just names on the trust prospects cards, with certain information noted regarding each. They are prospects of every bank in Chicago; some are ours for certain reasons; some more logically belong to other banks.

What means can we use to pique the interest of these desirable prospects?

1. Personal solicitation by trust representatives
2. Direct mail
3. Newspaper advertising
4. Billboards
5. Window displays.

PERSONAL SOLICITATION

Through personal solicitation we discover a certain percentage not interested in any trust plan or in the corporate executor; others have an inclination toward another institution and will not permit us to sell them; another group is ours. The process of selecting prospects or eliminating suspects through personal solicitation is a sure one, but how quickly the suspects can be eliminated depends upon the number of salesmen calling and the number of calls they make. Even then I feel that when a salesman returns and says to drop this name or that, the prospect might be sold by

another person of our staff, because personalities differ, and, where one salesman fails, often another will "click."

DIRECT MAIL

Direct mail, by mysterious means, falls into the hands of young men and women writing out of curiosity; customers of other trust companies who reply in order to receive a booklet out of curiosity, or to check up on the other trust companies they have named in their wills or trust agreements.

But, for the most part, direct mail for trust companies, well devised, written to "sell goods," and directed to the right persons at the right time will bring quality inquiries. If the prospect writes for a book or for additional information, see that he gets it immediately. And after he gets the thing he has asked for, see that he is called upon in a reasonable length of time, before he forgets what he wrote for or before a competitor gets in.

Let us for a moment take a look at the new business record of a leading trust company which mailed a series of six letters addressed to a list of wealthy prospects—customers and non-customers of the bank. Each letter carried a return card requesting either further information or a call on the prospect.

Of the leads received two per cent were discarded, for such reasons as that one did not wish to be called upon; the other had already named the bank in his will. Ninety-eight per cent of the inquiries were assigned to salesmen. Note what happened to the assigned leads:

Forty-nine per cent were reported as "no good." Three of these prospects listed "no good"

had already named the bank in trust matters.

Twenty-three per cent were found to be live prospects.

Twenty-two per cent were unreported to date.

Four per cent were sold by salesmen.

NEWSPAPER ADVERTISING

Now then, what does the newspaper bring to the trust company in the way of prospects? It brings the new business men their widest variety of suspects, for the newspaper is not a selective medium in any sense of the word. In a metropolitan area the problem is greater than in the smaller cities, for an inquiry received from a metropolitan newspaper may defy every method of determining its value. Often no hint can be obtained of the person's worth. His address is no criterion, for he may be rich but obscure. Great numbers of newspaper responses are from the idly curious, people of no means. If the newspaper advertising is properly pitched, the idle curious can be reduced and quality inquiries produced.

Sometimes it is better to make the entire solicitation of an obscure inquirer by mail rather than to take a chance on a fruitless personal call. You may lose some good prospects in following this advice, but names are not so scarce that you need worry.

Now let us observe the experience of a trust company in handling leads obtained from a three-month newspaper advertising program:

Twenty-nine per cent of the inquiries were answered by mail and then discarded as not worth further follow-up. These included inquiries from other

banks, from insurance companies, and from distant points, or from obviously blind addresses.

Seventy-three per cent of these inquiries were assigned to salesmen. On investigation, the following results appeared:

Seventy-three per cent of these leads were reported "no good" by solicitors. Some were from persons who lived in obscure or poor localities but who had to be called on to establish the fact that they were not prospects. Others were from students attending local law schools, from attorneys, from insurance men. A large percentage were those initiated through curiosity.

Ten per cent were reported as live prospects.

Thirteen per cent were unreported.

Four per cent successfully closed.

CONCLUSION

Now in conclusion let me add these few words:

1. Build up your lists carefully. Take your time. Ascertain that the persons have means, and then do your utmost to make as many as possible prospects for your services.

2. Do not add names to your lists until they have been properly evaluated. Just because three hundred persons answer an advertisement is no reason for adding them to a list. Ninety-five per cent of them may be no good; and fruitless soliciting is expensive. If your advertising is pitched to get quality inquiries, you will receive quality inquiries. A mediocre newspaper advertisement, carelessly

pitched, will attract the run of circulation.

3. Be sure that your solicitor immediately gets his fingers on the financial pulse of the inquirer, so that you will learn at once whether the individual is a suspect or not.

4. If you are after the higher unit of sale, you will have more suspects than those interested in a lower minimum of wealth.

5. Be on the lookout constantly for new names. Have a system that provides names of firms moving to your city; keep the latest club directories and civic and service organization rosters; keep in constant touch with the legal fraternity and with insurance underwriters. You men of the smaller cities have a comparatively easy job; those in larger centers do not have the same facilities for watching the changes in population.

6. An important file is your "dead file." Keep this up, and make constant use of it in checking prospects. It will save you many dollars in useless follow-up.

Remember that no name is a prospect until it has been definitely established that the person has means and that his business is unattached. Then he becomes a prospect. Up to that time he is a suspect. Be careful how you select your suspects. A good majority of them will develop into legitimate prospects.

Discussion

THE CHAIRMAN: In keeping up your prospect records, do you have the central file on that? You spoke of a central file. Do you run your trust prospects through your central file or have you a special trust file?

MR. EASTON: We have a trust

prospect file and that is subdivided into different sections. For instance, we have in one trust prospect file the names of women of independent means and can solicit their business from a different angle from the way in which we solicit men. We have another, a list of secretaries, treasurers, vice presidents, and presidents of corporations of certain capitalization and up. Those names are kept separate from the others. We are very careful to keep this trust prospect file weeded out.

I keep a file of trust literature of practically all of the banks in Chicago because their literature comes to some one, either in our own official family, directors or officers of our bank, or to others who place it in my hands. I don't get the literature from all of the banks but from nearly all of the local banks. Their files are not up to date. They are soliciting business from people whose business is already fairly well attached and they ought to know that.

We are constantly going through the files and adding new names. We pay a woman considerable money—more than we should, perhaps—but she is A-1. She knows Chicago and knows people and has ways of getting names of new people coming in, which is important, and of ferreting out that unknown stratum of men of high earning capacity who do not belong to clubs and who do not have established social position. Those names are not very easily found. Those names are secured from time to time from newspaper advertising.

Good as we think our files are, it is amazing to note, on certain mailings, the hands into which our literature or letters fall as indicated by replies from people whose names were

never in our files and never would have been, but secretaries or clerks or stenographers pick up the mail and reply for the employer in their own names. We try to be as careful as we can to keep the files filtered, so we do not get these obscure names that do not mean business.

THE CHAIRMAN: Do you have any way of checking mortuary records?

MR. EASTON: Yes, we do that every day. That is one of the important duties the first thing in the morning, to check that very carefully. We use the newspapers to do that.

THE CHAIRMAN: You spoke of a desk file. I would like to know just what you mean by that.

MR. EASTON: It was a "death" file, not a desk file. A death file keeps us from being foolish and spending money uselessly.

BESSIE M. SEELY (Union Deposit Trust Company, Detroit): Mr. Easton spoke about these prospects having means. I would like to get the idea of just how much means one should have in order to be considered a good prospect.

MR. EASTON: We will take an insurance trust as low as \$25,000. We have taken less where a man shows promise. We would rather keep the estates a little higher but we take them lower, too, if a man shows promise. I think that is something every bank has to determine for itself.

R. S. RACEY (The Chase National Bank, New York): After you have closed a prospect for a custodian account or a will, how much time do you allow to elapse before you solicit him for an insurance or voluntary trust?

MR. EASTON: That depends on

the person. Sometimes almost immediately. I would say that we try to judge it largely by the man's family and the property situation. Very often we find a situation where a man ought to clean up the debt immediately and in a case like that, it can be pushed a little harder. We are not like the automobile salesman, who sells you a car and then wants to sell you a tire rack and a horn and a windshield wiper and a half dozen other things the same day. We do not press them too hard, but we feel that the moment we have a piece of business from them, they are the best kind of prospect we have; we let the family situation and the property situation determine how we press it.

JOHN W. KRESS (Howard Savings Institution, Newark, New Jersey): How often do you change your files and revise them?

MR. EASTON: Constantly. It is a constant process.

DANIEL RIEBER (Merchants and Newark Trust Company, Newark, New Jersey): From your talk, I understand you do discriminate in the selection of prospects; that is to say, you secure wills or trusts, or rather, solicit them, from wealthy and prominent people. Would you refuse a person who desired to appoint your bank as executor under his will if his property did not amount to a great deal and you knew his estate was not large?

MR. EASTON: We would not refuse it. We are a semi-public institution and there, again, there are ethics of trust operation to be taken into consideration. We do not invite these small trusts, but if a man with a small estate comes to us, we will handle it, even though it costs us great sums above the fee to handle

it. Of course, the trust company can advise the prospect against it because very often it penalizes the heirs by subtracting the fee.

MR. MASTOIR (International Trust Company, Denver): The matter of checking the mortuary record or notices was mentioned. It seems to me that may have three phases: first, to check to see what customers have died whose wills or life insurance trusts are held by the bank; second, to keep the mailing list up to date. Is there a third possibility, the possibility of getting new business from the mortuary notices?

MR. EASTON: Very often you have more prospects after they get back from the cemetery. The logical follow-up, then, is to watch the probate records to see what the distribution is.

THE CHAIRMAN: An attorney came to my desk with a will which he had drawn for one of his clients and wanted me to pass on it. He said he was one of those lawyers who did not believe in banks attempting to do trust business and that he did not blame the lawyers for feeling that the trust companies were encroaching upon their prerogatives when they did so.

I believed I was salesman enough not to get into an argument with that fellow. I said, "Being an attorney myself, I agree with what you say with respect to banks encroaching on the lawyers' prerogatives. Our position is that we do not have retained attorneys. We give our law business to various outstanding attorneys here in the city. Of course, we have to be careful about an attorney to whom we give business, but if an attorney who gives us trust business is a reputable one, we make it an

invariable rule to retain him as attorney for the estate."

I ended by saying, "Frequently I have title matters which I would like to have you handle if you will." He said he would be glad to, and within thirty minutes, his partner, who had never given us any business, called up and said he had a client who wanted to name us as trustee; he asked us to help him in the plan and wanted to know if we had any objection to helping him in that capacity.

I said, "You don't want to be bothered with details. Where there is a joint trusteeship, neither of the trustees can act unless the other is present. You don't want to come down to the bank every time an instrument has to be signed. Suppose you name yourself in an advisory capacity."

He called up again in a few minutes and said that was what he wanted to do.

That occurred within an hour because I took the time to explain that our bank was not engaged in the practice of law.

Another client came to my desk and asked me to write a will and she requested that I confer with the attorney. I called the attorney and he said, "Have Culbertson write it and I will approve it." It all depends on how you handle the lawyer in the case.

I can see it from the lawyers' standpoint. When the banks get to the point where they disregard the legal professional ethics, they are inviting criticism from the nation and the condemnation of the lawyers.

MR. EASTON: I should like to make one more point and that is in regard to spending money for a list.

We made one bad mistake. A list company came to us and said they could give us a list of the people around the trade vicinity of the bank. They gave as references two Loop banks. We called the banks and were told that the list company was very reliable, that these banks had used their lists for years. We sent out the mailing piece to one of their lists. One customer of the bank came in, red-faced and furious. He was the executor and manager of eight

estates. The list company had taken his name, which was at the top of his door, and those below it, which happened to be eight dead men's names. One had been dead twenty-seven years and none had been dead less than twelve years. We had sent out our mailing piece to men who had been dead all those years. It shows how you can spend money if you aren't really wise, and I wanted to emphasize this matter of spending money in obtaining prospects.

Advertising and Solicitation

By H. L. DUNHAM

ASSISTANT CASHIER OF THE HARRIS TRUST AND SAVINGS BANK, CHICAGO, ILLINOIS

Address before the Denver Departmental Conference

Have you been overlooking valuable prospects? Did you know, for example, these statistics of the feminine pocketbook?

1. Women are receiving 70% of the estates left by men and 84% of the estates left by women.
2. Women millionaires, as indicated by individual income tax returns, are as plentiful as men.
3. Women are beneficiaries of 80% of the \$100,000,000,000 of life insurance in force in the United States.
4. Women already control 41% of the nation's wealth.

Mr. Dunham believes that the production of new business depends upon an attitude of mind. "If you are thinking of such possibilities day by day, there is little difficulty in picking up accounts. If you are not thinking in that direction, a hundred chances could walk right under your nose and never be recognized. The real producer, whether he be officer, solicitor, or employee, not only thinks about it, but decides to do something. He begins to uncover prospects for the bank, and it is surprising what almost any individual can do when he gets started in that direction."

THE new business program of any bank should have one eye critically trained on the profit and loss statement at the end of the year.

Your institution cannot assure itself of a normal, sound, and healthy growth by simply deciding that it wants new business and then organizing a concentrated effort to place a volume of new names on the books. In this day of rapid expansion there is a tendency to become the biggest bank in the town, county, or state without adding the necessary words soundest and best managed to the description.

The first step in preparing for a well established development program

is to decide what business you can profitably handle. If you cannot make a profit on trusts under \$25,000, certainly no effort should be made to bid for business under that figure. Naturally, the minimum may be lower or higher than the above named amount, according to the circumstances; nevertheless, it should be fairly determined on a profit basis by all trust departments, both large and small, and conscientiously observed.

ANALYZE THE BUSINESS ON YOUR BOOKS

Analyze the business already on your books as the next step in your preparation. A good way to begin

the survey is to assemble all those accounts that offer immediate income when the account is opened. Place them in group number one, together with a record of their net profits over a period of several years. Group number two should consist of the trusts you have received and a record of their net profits for the same period. Under group three, list the accounts you have obtained from indirect sources, including the names of the sources and the net profits. Such an analysis, with the comparisons it offers, will be both interesting and instructive.

ACCOUNTS THAT OFFER IMMEDIATE INCOME

Group number one will be composed of three types of business: corporate accounts; living trusts; custodian and agency accounts.

CORPORATE ACCOUNTS

It is obvious, of course, that not all organizations are able to obtain corporate accounts. If the circumstances are such, however, that this end of the business can be logically developed, certainly the profit it contributes to the earnings of a well managed department should assure its receiving an important, if not the first place, in a new business program. A real effort should be made to keep it in that position as the department grows and expands.

LIVING TRUSTS

Living trusts should receive next consideration. A careful check of each account should serve two purposes: first, to determine whether or

not there is any more business to be obtained from the individual, such as his will or insurance trust or both; second, to appraise his connections in order to decide what the value of his influence as a satisfied customer might be worth in soliciting these connections for living trusts or such other business as the particular situation might warrant. Overlooking the obvious is a trait that all of us share. All too often a valuable piece of business goes to a competitor for the simple reason that no one was aware of its existence.

Go a step further and see how much of this type of business has been brought in during the past two or three years. Then turn to your prospect list. Look over the situations that are possibilities for living trusts and see how actively they are being followed. You may quite possibly discover that you have not been working hard enough on a valuable type of business.

Many of these prospects are important enough to require the attention of the president, the head of your department, or other senior officers of the bank. If so, lay the results of such a survey before these officers. If you have not received their close cooperation before, the facts should serve to get action in a quarter where it is most needed.

CUSTODIAN AND AGENCY ACCOUNTS

Custodian and agency accounts hardly offer enough inducement in the way of adequate profits to warrant time and money being spent on them as new business possibilities by representatives of the trust department. Their greatest value lies in the direc-

tion of opportunities for other trust business and for closer cooperation with bond and banking departments. There is enough potential business in these accounts to justify the most careful check of each situation. Once you get the desired information, you can focus your efforts with telling effect.

By first segregating your immediate income-producing business you have obtained an excellent idea of the profit value of those accounts; you have secured new leads of real merit as well as prospects for further business, at a nominal expense; and you have established a sound basis for taking inventory of future new business activity.

It has been reported that a will is the standard piece of trust business and that the average age at which a man draws this document is fifty-five years. The average age at which he dies is seventy-two years, an interim of seventeen years before the trust department receives an income from the account.

TRUSTS AND NET PROFITS

The first concern of an analysis of group number two should be to get the following information: first, the number of wills and an estimated volume of the business represented by those instruments now on file; second, their average expectancy; third, the number and estimated volume produced each year, say for the past five years; and, fourth, the average becoming active and the average maturing each year.

It is not enough just to replace the business expiring from year to year. That must be done, of course, but any intelligent quota for annual production should take into consideration all

of the above mentioned information and be based accordingly.

In addition it should be worth while for you to list in separate columns the number of wills naming your bank as executor, the number naming you as trustee, and the number naming you as both executor and trustee. Compare the three lists. Those accounts where you act in both capacities are more favorable and profitable ones for the trust department and more serviceable for the customer.

DISCUSSION IN OFFICERS' MEETINGS

The question then arises as to just how resourceful you have been in selling the more advantageous arrangement. All of us are prone at times to accept the thing nearest at hand, only to discover that we might have secured the more desirable contract, had we been a little more alert and aggressive. It takes frequent reminders and constant training to attain that awareness of opportunity which characterizes a good salesman. For that reason it is a good thing to have a free discussion of such matters in an officers' meeting from time to time, and I know of no better way to keep those discussions out of the realm of generalities, where they have little value, than to bring up the hard facts gleaned from a thoroughgoing survey.

By taking stock of your deferred income-producing business in group two, you have not only dug up some percentages which should serve to set sanely your yearly quotas for future development of trusts, but you have valuable information calculated to sharpen up the wits of your officers and solicitors in working for the more attractive type of account.

ACCOUNTS FROM INDIRECT
SOURCES

Group three introduces another phase of a new business development program, the indirect sources from which accounts originate. I would begin by listing the number of administrator, conservator, and guardian accounts you have, adding to each account the source from which it came. Are you still getting business from those sources? You may be surprised to discover that you have neglected to keep in close touch with some of your best new business contributors. That oversight is especially common in the larger cities. A discussion of the subject in an officers' meeting fixes the responsibility where it belongs and assures closer cultivation in the future. No doubt there will be good suggestions made of new names that might well be added to the list.

In smaller cities it is comparatively easy to know and personally to keep in touch with the lawyers and judges who can direct this type of business to your bank. Though many of them may be customers of other institutions so far as their banking and investment business is concerned, if your organization has the only trust department in the community, you can certainly solicit their aid as well as that of your own friends in the legal profession.

In the larger centers the problem is somewhat difficult. Competition for business is keener, and there are more banks competing. That makes it all the more necessary for each trust department to be on its toes, not only to keep its old friends, but to make new ones. You can by no means ignore the business you may receive from them.

ALLIES FOR AN AGGRESSIVE
CAMPAIGN

Insurance underwriters make valuable allies for an aggressive campaign for trust business. I did not include the insurance trust under group two for the reason that it serves my purpose better here. Naturally, there are many insurance trusts obtained which have nothing to do with the underwriters. Their good will and cooperation, however, are necessary if you are going to make a comprehensive effort to build up that part of your business. Every name of value should be assigned to some officer to cultivate, by personal call, letter, some worth-while advertising, or all of them, if used judiciously.

Some banks keep close contact with certified public accountants, as well as with the underwriters for business insurance trusts, and are well pleased with the results. It is good business, and a friendly accountant can be mighty helpful in suggesting the value of such a trust and in seeing that the business comes to your organization.

The inventory of indirect sources from which trust business is secured completes our survey. The analysis should show that this business is the least expensive to get and for that reason all the more desirable. While you cannot go out and get it in the sense that you follow your other prospects, it is plain common sense to place yourself in the way of receiving these accounts when occasion arises. You cannot expect to get much, however, unless you spend a little time and thought on the other fellow.

With the facts of the three group surveys before you, there is little room for misplaced enthusiasm in planning and executing a thoroughgoing and

effective new business program, operative over a period of years. You know what you want and have only to test your resourcefulness in getting it. With such a complete preparation behind you, there is ample room for aggressive enthusiasm as you face the actual work of production.

There is no question but that the decade from 1930 to 1940 will be remarkably fruitful for trust departments throughout the country. Many years of patient effort on the part of trust organizations have laid a firm foundation for a broad and far reaching development over the whole trust field. It simply remains for the intelligent ones to take advantage of it.

ADVERTISING AND SOLICITATION

The two most efficient and reliable means of seizing that advantage are advertising and solicitation. They belong together and are successful only when intelligently used together.

Knowing definitely what you want in the way of new business gives you many well defined targets to shoot at, as you direct the fire of your heavy artillery advertising and solicitation. Living trusts are desirable. You can concentrate some of the fire of both guns on that bull's eye. You have the range and a clear mark for any other kind of business you want to aim at, which is much more satisfactory than hoping you will make a few clean hits while shooting at a blind target.

There are two broad classifications of advertising. The one may be defined as a policy of keeping your name before the public, a heritage of the days when banks thought there was little else they could do; and the other, as an effort to make a direct

bid for business by describing the services the bank has to offer its prospective customers.

Both classes may be, in the hands of a capable man, excellent advertising, and both may be used by the same organization with telling effect. That effect must be to sell, in the one instance, the name of the bank; in the other, specific services of that bank.

Even a name may be presented to the public in an attractive and imposing manner. I have in mind the "Powered by Lycoming" advertisements that ran in a popular weekly, as an example.

THE SALESMAN MUST BELIEVE IN HIS ORGANIZATION

The opinion common even among bankers, that all bank services are alike, fails to convince a good customer, employee, or officer when he believes in his organization. When that belief is "put across" in print, it succeeds in lifting your institution out of the "all alike" class. Individuality and character give it a distinct selling value to the public.

The manner in which the manufacturers of golf equipment sold the matched set idea to an ever increasing multitude of golfers has always impressed me. They were all selling the same thing and, in the main, probably a uniform quality. The "all alike" similarity of bank services and the many brands of matched sets seems a fair comparison for our purposes.

I doubt very much whether there is any one in this audience from dub to par shooter who does not own a set of matched clubs and who does not swear by (and sometimes elo-

quently at) his own particular make of stick. John Jones can tell you any number of things about his set, which is superior to that made by any other manufacturer. Each owner of a rival make can become just as enthusiastic about his own favorite.

As a matter of fact, if a close record were kept of every game played by every purchaser of a set of matched clubs, over a period of time and under similar conditions, I doubt if any appreciable difference would be noted in the net results. The important thing is that each purchaser is convinced that he is going to trim his score with his set, and I am equally sure that some day I will be able to shoot below 100 with mine.

What has all that to do with developing your trust department? Nothing or everything, according to the way you look at it. From my viewpoint, some manufacturer succeeded in convincing each one of us that we could not do without a set of golf clubs, though actually we did not particularly need them. He accomplished that by quality advertising on a generous scale. He sold you and he sold me through the effectiveness of the printed word and the enthusiastic indorsement of an increasing number of satisfied customers. Are our trust departments being sold as well?

SELL YOUR NAME, YOUR REPUTATION, YOUR SERVICES

Effective advertising is the process of selling the name and reputation of your bank and its trust facilities to the general public by means of illustration and printed word. It goes hand in hand with solicitation, which is little more than a highly selective, personal selling of the same things.

Good advertising should pave the way for solicitation. A test of its value in that connection is its ability to break down sales resistance and its capacity to build up sales morale.

If an organization is little known, has never made much of an effort to keep its name and services attractively before the public, just go out and try to sell for that bank. It will not take you long to become convinced that people do not like to give their business to such an institution when they can just as easily go to another much more widely and favorably known.

Discuss the question of sales morale and the effect of advertising upon it with men who are trying to sell the services of a bank without a well planned advertising campaign to back them up. They will tell you that they spend their energy and enthusiasm trying to "deliver the goods" only to return to the office with the feeling that a wet blanket is being thrown over them. They soon lose heart, the punch is gone, and the salesman does not sell.

Advertising designed to present the specific services of the trust department has two possibilities, education and a direct sales appeal to the public. It is with the latter that we are now concerned. It should have definite pulling power of its own; the best gauge of its effectiveness is the number of inquiries obtained. Trust department facilities offer a better opportunity for that kind of advertising than almost any other bank service. The advantages of a particular trust service, presented on a sales basis, will enable you to close many a prospect as the result of an inquiry sent in.

Direct mail advertising proves a very satisfactory medium for selling

trust services. Not only can you estimate its value by the number of inquiries received, but you have prepared the recipient for a call from a representative of the bank. It has the advantage that it is more selective than newspaper advertising, which is broadcast to the public. A good direct mail list should be made up of choice names from the customers and prospects of all departments of the bank.

PAMPHLETS

Our own organization carried out a successful campaign in this manner, issuing one pamphlet describing one particular type of trust service each month for a period of six months. Invitations were enclosed with each mailing to inquire for a master booklet giving a more detailed story of the subjects touched upon in the single issues. Each month the same advertisement that went into the mail appeared in the local newspapers.

The list was carefully chosen. We felt that we were taking this opportunity, since we were unable to go out immediately and personally interview each individual, to have a talk with him about trust matters. The copy was written in that vein as closely as possible.

The results were very interesting. We had an excellent test of the value of our advertising, which in this case was more than gratifying because of the number of inquiries that flooded in. We had also paved the way for numerous personal calls.

Direct mail cultivation of indirect sources from which new business is obtained should be a part of any well organized advertising program, especially in the larger cities.

It is human nature to be deeply en-

grossed in our own affairs, and all of us have to be reminded from time to time of the things we should do but neglect, mainly because we do not have these matters actively in mind. Overcoming that inertia is one of the objectives of advertising. To achieve it there must be some purpose behind the reminder, something sufficiently worth while to cause the recipient of a piece of literature to pause and give some thought to us and what we want.

We have been mailing a monthly service to many of our friends in the legal profession. The pamphlet reviews pertinent information regarding decisions, and decisions pending, in connection with estate matters. It has the advantage of calling attention to the name of our bank and at the same time giving information that may be of value to the lawyers in dealing with their clients.

The same attention should be given your good customers and prospects. When you are unable to keep in close personal touch with them, it does not pay to overlook the possibility of maintaining a friendly contact through the mail.

WOMEN IN BUSINESS AFFAIRS

Let us take a concrete example of an oversight which may apply to many of us who are interested in new business. The tendency to minimize the importance of women in business affairs has, perhaps, blinded us to their importance as prospects for trust business. The following items appeared in the Nashville Banner of April 7, 1929, and are pointed enough to open our eyes:

Women are receiving 70% of the

estates left by men and 84% of the estates left by women.

Women millionaires, as indicated by individual income tax returns, are as plentiful as men.

Women are beneficiaries of 80% of the \$100,000,000,000 of life insurance in force in the United States.

Women already control 41% of the nation's wealth.

Here is a wide field for a new and more interesting note in trust advertising and solicitation. In addition, I sometimes wonder just how clever we prove ourselves to be when we fail to take the wives of many trust prospects into full consideration in soliciting trust business. One of the men in our own organization told me of his situation. He wanted to place his insurance in trust with our trust department; was thoroughly convinced it was the wise thing to do. His wife did not agree, failing to see any advantage in the arrangement. Though his trust is on the books, he tells me his wife is skeptical about its value even today. If that is true of a banker, how much more is it apt to be true of some one who knows very little about banks and their services. Certainly if the wives are sold at the same time as their husbands, much of your sales resistance is removed and the odds are greatly in your favor for avoiding long delays in closing the business. If both have a good opinion of the character and standing of your institution, your possibilities for favorable advertising by word of mouth are doubled.

ADVERTISING SHOULD EXPRESS THE INDIVIDUALITY OF THE BANK

The character and individuality of a bank should be expressed in its ad-

vertising. If your institution does not employ an advertising manager, a simple manner of experimenting would be to collect the advertisements of several representative banks in two or three of the larger cities. Study them and adapt the ones that impress you most, to your own situation. You may discover, of course, that your prospects will not be impressed in the same manner, but you can always try again until you register. A trip to your city correspondent once a year, and a chat with the advertising manager there will be helpful. If you are not acquainted with the Trust Company Division of the American Bankers Association, you should make it a point to become a member and benefit by the assistance it can give you. Such things as direct mail advertising material can be supplied at a nominal cost, not to speak of suggestions for the development of your department and for efficiency in its operation.

The same character and individuality which distinguish your bank and its advertising should be evident in the quality of the men who represent you before the public. The highly selective, personal selling of your bank and its services by solicitation is no longer a matter for discussion. You have to do it and you must have the men who can "advertise" you favorably.

THE OFFICIAL STAFF AS SOLICITORS

By solicitation I do not necessarily mean an organized new business department with a staff of paid solicitors. They are needed for banks geared to production on a large scale, though they lose much of their effectiveness

even there if they are not loyally supported by the officers of the trust department and by the rest of the bank.

I do mean the official staff of the trust department. As one individual expressed it, "They should have time to put their feet on their desks." In other words, they should have their work so arranged that they can take a definite part in productive activities.

Each officer of the trust department should take his share of new business work, allotment being made by the head of the department according to the officer's abilities and the nature of his duties. If that is not done, the real purpose of any new business program is defeated. The problems of such a program are to get new business and to hold the business you already have. When an officer takes an active part in working out a solution for those two problems and goes outside the bank to do it, he has for the first time discovered what it takes to keep his department growing and what his own relationship to that growth should be. He is a better cooperator with solicitors and with the officers of other departments, and he is much better equipped to deal with the public in his own office.

Many banks have followed the practice of setting aside half days for each officer each week, when he is supposed to be out on the street. To insure consistent effort, consideration is given, in the matter of salary and promotions, to the success of new business activities.

INCENTIVES TO PRODUCTION

Let me emphasize here that every effective incentive to produce consistently comes from the executive

officer of the bank. Unless he takes an active interest in the production program, receives reports, makes salary increases and promotions as described, not only will much important business fail to be placed on your books, but the rest of the staff will never be genuinely convinced that production is a necessary part of their work. The president of an organization can get needed action when it is often difficult for others to achieve it. The head of the department should see that the desires of his chief are carried out and assume his own share of interest in important accounts where his influence carries the most weight.

Bring capable solicitors into that sort of organization and you get excellent results. They receive needed cooperation from their superiors, are backed by good advertising, and feel that they are going along with, rather than pulling against, the tide. They belong to an institution they can conscientiously sell.

There are varied opinions as to what makes a good solicitor. Certainly there are no rules laid down. I prefer to look upon him as a potential officer of the department. If I cannot see that possibility in him, I am not much interested. He will hardly possess the dignity, character, and personality to represent the bank in the manner most desired. He should have legal training, selling ability (though none of the go-getter characteristics in the sense in which those words are commonly used), be a pretty good judge of human nature, with the capacity for being tactful and diplomatic, and still retain the aggressiveness and determination that mark a good salesman.

That is a large order and a hard one to fill. It is true, however, that

one man of that type is worth two or three mediocre fellows, and for that reason very much worth looking for.

He should by all means receive enough training throughout the bank to know the officers and the organization and its policies, and to absorb the spirit which distinguishes it from its competitors. That is not done in a day. I cannot quite conceive of a salesman's representing a bank, especially a trust department, who has not a firm belief in the character, reputation, and personnel of his institution. After all, the personalities of the officers and employees who deal with the public play a large part in creating the good will that means satisfied customers. The salesman who does not know the official staff and believe in its abilities to take good care of the customers he brings in, can hardly present a convincing sales talk to his prospects.

SPOT YOUR VALUABLE EMPLOYEES

Last but not least, your employees should be included to round out an effective program. I have always felt that there is what I choose to call a clerical type of mind, as contrasted with another type of individual who thinks for himself and is willing to back his judgment. You can hardly hope to do much with the first group. Your job is to spot those belonging to the second class and gradually give them more responsibility until they show signs of hitting a stride. They will then gain confidence in themselves and travel under their own steam. These men should be carefully trained to take their places in the official lineup. If you are giving them such a training without including the necessity

of production, you are leaving the job only half done.

I recall two banks I visited last year and the impression they made upon me. In both of them, the entire official staff, with the exception of the president (and in each case he had been recently elected) was made up of gray haired men. I looked for some young fellows who might be assistant cashiers, but every man holding that title was well along in years. I looked over the employees, saw some rather likely looking chaps, and casually asked one of the officers what their responsibilities were. He assured me that they were fine boys and that the bank thought well of them, but he was uninterested when I delicately suggested that by increasing the range of their activities the bank might be testing these fellows out, and by that means might discover whether or not they had real stuff in them. Some day I suppose I shall be reading that this or that officer of one or the other of these banks has retired or passed on and will be replaced by some one brought in from outside the organization.

An officer in another bank, when the comment was made that he seemed to have a high grade type of employee in his shop, replied that they made a point of hiring that kind. If that were true, it occurred to me that they must give them careful training in every way possible to increase their potential value. When asked if that was right, he brightened and said it was so. He enthusiastically pointed out a fine looking chap behind a teller's window, the very fellow who had attracted my attention, and said that this man was particularly good. Every time an account closed or was about to close he would report it to an offi-

cer. Fine, but that was the extent of the officer's comment. I would lay a good bet that that young chap would have had real possibilities if he had been given the proper training and encouragement. If he had the wit to report closed accounts, why not dig up half a dozen other things for him to do, or transfer him from the cage and let him show his mettle? That is the only way any one will ever discover what he is made of.

We have found several new business men during the past three years and believe we have more who could so qualify, not to speak of fellows who have demonstrated ability in other directions. The latter group are being given a sound idea of the importance of new business in their plans for the future. As they progress, we aim to give them definite new business responsibilities, increasing them as the men develop.

PRODUCTION OF NEW BUSINESS AN ATTITUDE OF MIND

After all, the production of new business is pretty much an attitude of mind. If you are thinking of such possibilities day by day, there is little difficulty in picking up accounts. If you are not thinking in that direction, a hundred chances could walk right under your nose and never be recognized. The real producer, whether he be officer, solicitor, or employee, not only thinks about it, but decides to do something. He begins to uncover prospects for the bank, and it is surprising what almost any individual can do when he gets started in that direction.

We have a young officer who picked off an occasional small account from a friend or two before he was

promoted. At the time he was made an officer, the new business possibilities of his position were put squarely before him. The effect was gratifying. His record the last year and a half has been remarkable. Today he does not overlook a single bet that comes his way and gets a tremendous kick out of it and is greedy for more. He is one of the best illustrations of what a man can do when he is given the proper incentive. If you called him a salesman he would laugh at you, but he is, and his value to the bank will increase rapidly as the years go by.

There is just one thing more. To maintain successful production year after year, remember this: it requires some one with the patience to analyze your business and your personnel, the imagination to see the possibilities in both, the ability to sell the program to the officers and employees, then get them to sell it to the prospective customers of the bank, and the courage to keep everlastingly at it. That sort of program will be effective the year round; an aggressive and intelligently directed effort to keep your institution well in the front rank of sound, well managed banks of your particular size and class is of the first importance.

It is no longer a question as to whether or not the job should be done, but as to how well you can do it.

Discussion

BESSIE M. SEELY (Union Deposit Trust, Detroit): I should like to ask Mr. Dunham if he feels that it is good policy for the solicitor to put himself as well as his institution before the prospect, so that when he calls on a customer, instead of being announced as a representative of the

Northern Trust Company, he can be introduced as Mr. Easton of the Northern Trust Company.

MR. DUNHAM: This is, of course, just my own personal opinion. I like to deal with a smart salesman, and every smart salesman I ever encountered sold himself as well as his bank. I think any individual who does that sort of thing well does a better job than one who merely presents the information and that is all; I prefer a salesman who sells himself as well as his bank.

JOHN W. KRESS (Howard Savings Institution, Newark): In your opinion, which method of solicitation is more fruitful, direct mail or personal?

MR. DUNHAM: That all depends on the situation. As I see it, it is a combination matter, anyway. I do not think you can close every situation by direct mail advertising and certainly your good situations demand the attention of a solicitor. Does that answer your question?

MR. KRESS: Do you think it necessary to send out solicitors in every case or is it possible to get people interested through form letters?

MR. DUNHAM: I think Mr. Easton covered that very well in his analysis of the suspect and the prospect that he gave to you. My answer to that would be exactly the same as his. In other words, if you can eliminate the solicitor to a certain point, okeh. After that point, if you have to use solicitors to eliminate suspects from prospects, that is what you will have to do.

THE CHAIRMAN: Ordinarily, can you close prospects by direct mail advertising?

MR. DUNHAM: It is a possibility to be hoped for. In some cases it

might work that way. What I mean is, that possibly the individual could be gotten into the bank as the result of direct mail sales or news advertising, in answer to an inquiry. If your letter is so couched that you can influence the prospect to come into the bank to discuss his particular proposition with the officers of the organization, that is fine; you stand a reasonably good chance of closing without sending a solicitor, but if you can't get him in to the bank and do not have an opportunity to appraise the value of the name, you would want to send out a solicitor.

W. R. PLUMMER (American Trust Company, San Francisco): You made the statement, Mr. Dunham, that you make a practice of mailing recent court decisions to attorneys monthly. May I ask if those decisions are decisions just of your own state courts or of courts all over the country?

MR. DUNHAM: It is an estate and tax news service put out by the Prentice Hall people covering decisions all over the country.

MR. PLUMMER: Do you type those decisions as you receive them from Prentice Hall?

MR. DUNHAM: No, they are published and we use the service just as they send them to us. We contract for so many and mail them out.

BLANTON DORMAN (First National Bank, Shreveport, Louisiana): I should like to ask, when the solicitor has succeeded in getting the prospect into the bank, what is your policy with reference to having the solicitor who brought the prospect in sit in on the conference between the trust officer who closes the deal and the prospect?

MR. DUNHAM: I have some very definite personal opinions with regard

to the status of the solicitor, both in the banking and the trust departments. I like to see the solicitor given every break possible for this reason: I like to look at him as a potential officer of the trust department or banking department or whatever department it may be. That being the case, I don't

see how a salesman can be given any dignity or how you can expect him to solicit a prospect and bring him into the bank and then shut him out of the conversation after the man is in the bank. That would be the same as telling him he is a "small potato" and that he should "shove off."

Life Insurance Trust Development

By FRED W. STEINER

ASSISTANT SECRETARY OF THE EXCHANGE TRUST COMPANY,
TULSA, OKLAHOMA

Address before the Denver Departmental Conference

During the comparatively short existence of the life insurance trust, a whole code of ethics and a whole plan of procedure have developed. Relations with the life underwriter and with the attorney—those two close associates of the insurance trust man, who might so easily become his bitter rivals—have been lifted to a plane of cordial cooperation. Measures for building the business, and for training salesmen especially qualified to work to this end, have grown up, and publicity systems have evolved, calculated to spread abroad the knowledge of this new and beneficent instrument for man's reassurance and protection.

Mr. Steiner is himself strongly impressed with the sacred responsibility of the trust man, and he treats his subject with seriousness and conviction.

SINCE about 1816 the trust business and the life insurance business have been very closely correlated. In fact, the first trust company presumably organized in America was organized as a company primarily to grant annuities. Likewise, several of the earlier insurance companies attempted to do a certain amount of trust business. However, the trust companies and the insurance companies discovered early in their history that each had a very separate and distinct duty to perform for the benefit and welfare of mankind.

The fundamental principle underlying life insurance is to create an estate for the benefit and protection of the dependents of the assured, while the fundamental principle underlying the services of a trust company is to conserve, manage, and protect an estate that has already been created. Therefore, the fundamental purposes underlying insurance

activities and trust company activities do not conflict in any way. On the contrary, life insurance companies have almost an exclusive field for their operations, and the trust companies have an exclusive field for theirs.

Trust companies, in developing the insurance trust, are taking up the work where the life insurance companies' duties and responsibilities have ended. With this thought in mind, the insurance companies and trust companies throughout the country have established a cooperative movement which has been of advantage both to themselves and to their beneficiaries.

EARLY DAYS OF THE LIFE INSURANCE TRUST

The first record we have of a life insurance trust was that executed on January 27, 1877, by the Provident

Trust Company of Philadelphia. While there have been insurance trusts executed at intervals since that time, it is only in the past few years, through the efforts of the American Bankers Association to provide a plan whereby the banks and trust companies could cooperate with the insurance companies in the protection of life insurance after it is paid out, that the life insurance trust has become a vital and forceful factor in the scheme of things today.

In our state, Oklahoma, there is over \$1,000,000,000 worth of life insurance in force. Let us assume that this amount will be paid out in the next twenty-five or thirty years to numerous beneficiaries. In 1928 the Department of Commerce in Washington estimated the wealth of Oklahoma, in addition to the life insurance to be paid out, to be approximately \$4,000,000,000. I bring you these figures to show the importance of the life insurance business and the possibilities of trust companies in the field of insurance trust development. See what Oklahoma offers and then check your own state.

BUILDING THE BUSINESS

How are we going to develop this business? First of all, the trust company must be well organized in each and every department. It is often said that no chain is stronger than its weakest link, and this axiom is certainly true with respect to trust company organization. Our house must be in order if we are going to aid our neighbors. The mistakes of an officer or an employee in any department of a trust company may cause the company much embarrassment and the loss of friends, and are always

detrimental to successful business growth.

After having established such an organization, the next logical step in building this business is selecting a personnel for the sale of the service. A representative should know much about the trust business as a whole if he is to interview a prospect successfully. He requires character. He should possess tact and diplomacy. An education above the average is an essential here, as in other important fields. He should be a good business man with a heart, and have all the natural instincts of a salesman. Earnest work and close application to his company's policies and methods in all lines of finance must be his habit if he is to succeed. Certain types of men are marked for success in this undertaking, while men who might be good salesmen in other lines would fail here. Much depends on the qualities of the man. He may be young or old, but experience is valued here, if enthusiasm can be retained, as in other important missions.

TRAINING YOUR MAN

Before a representative is sent to discuss the matter of a life insurance trust with a prospect, he should be imbued completely with the trust idea, and he must be thoroughly sold on the service of his company; he should have at his command such literature as will better acquaint him with the growth of the trust companies in America and their early background. In preparation for this work, let him collect all the institutional pamphlets and literature on the subject, copy and analyze a specimen document, learn all the technical terms contained therein, and study all the clauses and

the reasons therefor, giving particular attention to fees, the laws of his state relating to trust matters, and the mechanics of the operation of an insurance trust from its inception to its close.

Much has been written on the subject of training methods. Until recently there were not many successful formulas available. Institutions developed their own sales methods, pioneering alone in many instances. This was true in my own institution. But with insurance trusts and estate building becoming recognized sales problems, the Trust Company Division of the American Bankers Association began a careful study of the methods of training salesmen. It called five men who had pioneered in this field and had established themselves as authorities. I am happy to say that one of the executives of my own institution, E. Fred Johnson, Vice President, was called on this committee. It was headed by John A. Reynolds, Vice President of the Union Trust Company of Detroit. The object of the committee was to write and publish the first manual for sales training in the trust business. Only recently the American Bankers Association issued the manual, and it is now available.

Conferences, headed by men with broad and early experience similar to that of our chairman, had been the only means, prior to this first published undertaking, of acquiring information regarding the selling of this service. It would be impracticable to discuss further all the requirements here, but my original suggestion on acquiring literature, and so forth, holds. I mention these other things that you may know where such information is available.

It would not be wise to send out to sell trust service for an institution a man that the officers, directors, and stockholders—and, yes, the employees—had not found helpful in caring for their own estate program. We firmly believe, as was implied in the beginning of this discussion, that our own house should be in order, in that prospective clients may be honestly told that our officers and directors have entrusted their insurance and estates to our trust department and are sold on this plan of distribution. In our institution this has been done, and we proudly boast of the accomplishment. Indeed, it is a strong factor in the early days of development to point to this accomplishment.

And, in passing, let me observe that after you have gone through the process of working out your officers' and directors' programs, you remove their antipathy to discussing with some present customer of the bank that customer's trust service, for fear they will be tripped up over a technicality. Successful trust business development requires team work. While our experience has been that an officer engaged in other endeavors will not have sufficient mastery of detail to work out a man's individual insurance or testamentary trust program, he can open the door for this expert we have been talking about. Therefore, the contact with the customer frequently is made by an officer or an employee. When the customer has been shown the necessity of making an insurance trust, he should be introduced to the trust representative, who will follow up the prospect in an orderly manner. It has been demonstrated that a specialist in any line of business or endeavor makes the greatest success. This is certainly true in the develop-

ment of life insurance trust business.

THE IDEAL SALESMAN

A director of a large, successful trust company recently made this statement: "While we believe that the ability to sell an idea is the most important talent that a trust salesman should have, it takes the highest type of man to inspire the confidence that is necessary to cause men of means to entrust the settlement of their estates to banks and trust companies."

It has been proved that failure, where it has occurred, has generally been due to sending a representative insufficiently or improperly trained to visit clients. It is also a serious mistake to attempt to economize by adding the duty of procuring this business to an individual or individuals of other departments, who, both by temperament and by training, are unfitted for this work. Again let us repeat that this work requires experienced authority.

You will observe that up to this point I have devoted a great deal of time to salesmen, their training, qualifications, and requirements. Since the subject assigned me was Life Insurance Trust Development, this procedure may have caused some question in your mind. But essentially I have assumed that I was invited here because of our experience in Oklahoma, that we might share it with you, and we have found the solution of the development of this business in the personnel and their qualifications. I do not propose to discuss life insurance as an institution, nor its many uses, even through flexible arrangements permitted by trusts. My subject calls for the development of this business, not for its technical analysis.

COOPERATION WITH THE LIFE UNDERWRITER

To date, no field offers a potential yield comparable to that of cooperation with the life underwriter. He will be a messenger of your organization if you show him proper respect. I mean that you must give him proper attention and service, and your salesmen must understand how to receive and to treat this ambassador of your institution. We agreed in the beginning that trust companies and insurance companies are similar fundamentally. Then let's honor the underwriter who has joined us in our mission. He helps the trust man in many ways, but here are four definite ones:

1. He teaches us more about the principles of his business.

2. He creates a serious demand for trust service. How? If he is an underwriter, he can analyze the estate of his client, and develop the necessity of insurance and its wise distribution.

3. He creates a necessity for all of our trust services, as well as frequently of our banking services.

4. He qualifies himself and makes his services available to our clients as an insurance counselor with whom we can freely advise.

But, we ask, how may we, in turn, deserve this cooperation?

1. Usually men respect you whom you respect, and it follows that a desire to cooperate on your part brings about cooperation on theirs. This is essential above all else if you intend to have the underwriters of your community utilizing your institution above those of your competitors.

2. Show the underwriters how trust service is handled, step by step.

3. Teach them to be as familiar

with an insurance trust as with the details of an insurance contract.

4. Create a demand for their merchandise; stay out of the insurance business, and keep your trust company and bank employees out of it. Work diligently and honestly to help the underwriter sell his institution of public service.

5. Give excellent service in the administration of insurance trusts, and the public will be appreciative and convinced that life insurance trusts can and will meet the needs of their families, and that the insurance man is their friend.

Dealing with insurance men requires from the development personnel of your institution complete neutrality, and frequently great tact, to avoid conflicting selfish interests on hard competitive cases of life insurance. It should be remembered that we are selling the need for life insurance, but in no case do we attempt to suggest from whom this insurance should be purchased, when occasions arise in trust matters where additional insurance is required. We should recall that all matters coming to us from any source are confidential between us and that source; no obstacle to trust business is harder to surmount than the thought on the part of the public that their private and personal affairs are available to many minds and tongues. Insurance men who do not feel free to invite you into a case that they have started, that you may help them plan a complete trust program to their ultimate success in writing more insurance, will not long remain the friends of the insurance trusts if their interest is not protected, because, after all, fees are essential to the survival of the business of both trust and insurance companies.

Attorneys, too, have an important part to play in the matter of developing business. Cooperation with them should be a fixed policy. Their clients frequently ask their judgment on so important a thing as the life insurance trust, and an unfriendly word spoken at the wrong time by them can spoil the work of many carefully planned days, whereas cooperation will bring success.

PUBLICITY

Publicity! Whoever invented the word must have been a romantic cuss! Even the women's clubs say they must have a publicity chairman. And, Babbitt or no Babbitt, publicity really is what oil is to a motor car, or a comfortable seat to the farmer's cultivator, or method to business. Publicity is the expression of all the fine services we actually render. It is the educational department of this public mission in which we have engaged—the textbook, if you please, that tells all who will learn how they may better know what excellent features can be found in so simple a thing as a life insurance trust agreement. But we are talking about constructive advertising—not an advertisement on the back of the church ice cream social program. Its mission must be to create a reception on the public's part both of the insurance trust idea and of insurance itself. Indeed, it is essential to the development of the insurance trust business. We used to think that publicity could get all the business, and it did get much, but now it has a vitalizer—the walking agent, who has an individual program for the individual man.

If we had more time, we might

discuss methods—the compiling of prospect lists for circulation, the preparing of good newspaper copy, with request for booklet circulation, street car cards as compared with billboards, and the advantageous use of booklets and letters. But let me sum it all up by saying that, like the women's clubs, we believe in publicity chairmen.

However, my friends, the development of insurance trust business requires above all one element that is the essential ingredient of every right activity—work! Just plain old hard work, backed up by some of the things that have been outlined here, will build the successful institution of the future.

To those engaged in developing insurance trust business it may not seem an alluring picture, for we are dealing in futures, in securing insurance trusts, and often there is not the enthusiasm for future achievements that is found in something that has a more immediate profit. Vision is required, and patience. We must know something of our high calling and be willing to pay now, that those who come after us may enjoy the fruits of our labor.

Men, character, methods—these three have made insurance trusts profitable in a new state, Oklahoma, as is evidenced by the first trust company, the Exchange Trust Company, which is but eleven years old. Our company believes in actively pursuing new business of this type, and other trust business. In bygone days a banker was distant and his bank forbidding, but today the progressive institution is receptive to this idea of soliciting new business. The day is not long past when the solicitation of business through representatives was

considered undignified, and even unethical, but these objections have been dismissed, and the past ten years have shown that modern methods of securing business are practical in every way, and the development of insurance trust business has brought much of this about.

We now believe that, as one of our executives has said, "Perhaps there is not a commercial institution known to the American family that has the ideal conception of service that was conceived in the modern trust company in gathering together the products and hopes of the people, distributing into commerce and industry the usefulness of these gains, and perpetuating the family circle, stabilizing a family ideal; the trust company is charged with the most sacred responsibility that man could charge to man." This is our glory and this is our responsibility—to be a friend to the family and to protect sacredly all that man can bestow on his family. Such a calling is an important one and has all the charm of romance and adventure; each new day finds a way to serve those who have been entrusted to our care.

Discussion

MR. MASTOIR (International Trust Company, Denver): I should like to ask that you preface your answer by giving the population of Tulsa and then tell us what you consider to be a fair sized mailing list for prospects for an institution in a city of that size.

MR. STEINER: The city, within the corporate limits, is 140,000, but we have many suburban cities adjoining us, so that the total population, is approximately 180,000. We

have a mailing list of, I believe, approximately 5,000 names and we send out booklets and circulars in a systematic manner about once or twice a month.

MR. MASTOIR: Does that mean your trust prospect list is 5,000?

MR. STEINER: Yes.

MR. MASTOIR: How do you handle a case where you get two life insurance men on the same trust case?

MR. STEINER: We are usually able to handle that very diplomatically. It has occurred many times. We usually wait until the insurance man has sold the prospect and he is brought in to close the trust.

MR. MASTOIR: My own method on that has been to tell each man there was another man on the case.

MR. STEINER: We often find that the prospect will try to trip us up on that and will ask you who has the best policy or contract. We al-

ways check that to their own judgment.

MR. MASTOIR: You referred to the comparison between billboard and street car card advertising. Which do you think is better, and what do you think of street car card advertising?

MR. STEINER: I think street car advertising is better than billboard because people are sitting in the car thinking and if the cards are properly written they have effect.

MR. MASTOIR: What results do you know of from street car advertising?

MR. STEINER: It is hard to determine indirect advertising. When a prospect comes in, we don't really know what made him come in. There are many possible influences. He may be a friend of a stockholder or a director, or it may be general advertising that has interested him.

The "O—O" of Trust Development

By R. S. RACEY

ASSISTANT CASHIER OF THE CHASE NATIONAL BANK OF THE CITY OF
NEW YORK, NEW YORK

Address before the Denver Departmental Conference

In organizing and operating the "O—O" of trust development, the first step is, logically, the analysis of the potential market. In a complete analysis there are several problems to be considered, such as the value of the potential trust business in the community; the possibility of increase or decrease in this volume over a given period; the share which your institution has reason to expect; all the costs and charges involved in such services. If you have good cause to feel that there is profitable trust business available to you, your problems become production (or mechanical operation) and sales.

Constructive selling rests upon a foundation of advertising, publicity, direct mail, and personal sales effort. The personal contact is, without doubt, the final and determining factor, but it can be well prepared for by the wise use of advertising, publicity, and direct mail.

The expenditure for each of these four approaches to the prospect depends, of course, upon the amount of money the institution wishes to spend for this purpose. This amount must be determined before a tentative sales program can be set up.

EVERY trust department exists by virtue of two functions performed:

1. Production of service
2. Sale of service.

Sales could not be effected without production. Production would be wasted without sales. Most important, it is useless to produce or sell unless there are profits, either present or prospective.

During the past few years it has been my good fortune to discuss trust development with a goodly number of progressive men from communities varying greatly in population. Many interesting facts have been brought out in these meetings, and with these I propose to combine some personal experiences and observations in this brief discussion of the problems of

those who have recently entered or are about to enter actively the field of trust development.

For the purpose of my discussion, any references to "trust services" will be primarily personal trust service, such as service as executor, administrator, or guardian, or trusteeship of testamentary and voluntary trusts.

Just as successful building is done by plan, so must successful trust development be done by plan. Since the final objective of trust development is profit to your institution, the first consideration should be your market, or the field which you may reasonably expect to serve at a profit.

ANALYSIS OF THE MARKET

Critical observation of the market,

or what might be better termed "market analysis," should be given serious consideration even before the problems of sales and production are taken up. Trust service is such a personal matter that for the present, at least, its market may well be considered a purely local one. In any community, regardless of size, there are certain questions, the answers to which may be depended upon to guide you in planning trust development. They are:

1. What is the value of potential trust business in your community today?
2. What possibility is there that this volume of potential business may increase or decrease during the next ten or twenty years?
3. What share of this potential business could your institution reasonably expect by virtue of its present size and standing in the community?
4. What fees and commissions would you be entitled to?
5. What would be the approximate cost of performing the services?
6. What would be a reasonable expenditure for obtaining this business?

These and probably a number of other related questions might well be asked in the consideration of your market. However, from the points touched upon in these suggestions, I feel sure that you will agree with me that the practical application of "market analysis" is the proper starting point in development and that it will serve as a basis for organizing and operating, the "o-o" of trust development in any community, regardless of size. From such an analysis you may gain a fairly definite idea of the extent to which your immediate outlay of time and money is justified in developing business, a large part of which may not be revenue-producing for some years to come.

PRODUCTION AND SALES

Now, let us consider that you have your market defined and have good reason to feel that there is profitable trust business available to you. The next consideration is that of production and sales, the two functions by virtue of which a trust department exists.

Although production and sales have a common objective, they present two distinct problems:

1. Production represents the mechanical operation which determines your cost of rendering trust service.
2. Sales represent the methods by which the public, or your ultimate consumer, can be influenced to use that service at a profit to your institution.

SALES ORGANIZATION

Having pointed out the close and vital relationship between production and sales, I am going to leave the former subject for the present and discuss sales organization and operation in such terms as I feel may be applicable to any community, regardless of size.

Constructive selling rests upon a foundation of advertising, publicity, direct mail, and personal sales effort. Through publicity the prospect knows your institution. Through advertising and direct mail he knows your service. Through personal solicitation he is induced to buy. Only by a proper combination of these elements can the desired results be obtained. The extent to which publicity, advertising, and direct mail are to be used depends entirely upon your local situation. The one element, in all situations, which must complete the struc-

ture is the personal sales effort, which is the determining factor in successful trust development. Whether the personal contact be through full-time solicitors or by the operating personnel of the trust department, it is by far the most vital point in the sales structure.

Through these four media of development we have two general types of sales to be accomplished:

1. Offensive selling, representing your efforts to procure new institutional customers

2. Defensive selling, representing your efforts to retain present institutional customers and to sell them trust services in addition to the ones already used.

Advertising and publicity provide the approach to the general market. Direct mail breaks down the general market into a selected one. Personal solicitation calls for the highest degree of selectivity in order to define the immediate and most logical, as well as the most desirable, market.

DETERMINING AMOUNT TO BE SPENT

The time and money expended on each of these media will be determined by the price your institution feels that it can afford to pay for the business available in your community or your market. Obviously, we cannot all have highly specialized departments for these activities, owing to the expenditures involved. However, any institution determined to develop trust business must "organize and operate" with these media in view.

In larger cities, where the market is ample, you will find individuals and even departments specializing in each line of approach. As the mar-

ket becomes smaller, the personnel naturally diminishes, and these approaches are handled at a correspondingly lower cost.

Before proceeding let me say that the figures I am about to use are not based upon experience, but are used merely to show my impressions of the points to be considered in determining the amount which might be set aside for acquisition costs.

Let us say you have a bank or trust company in a city of 50,000 population. You have estimated that there is a possible \$50,000,000 in potential business in the community within the next ten years. There are four banks which might be entitled to this business, and by reason of the standing of your institution you should be able to control 40% of this business, or \$20,000,000 in estates. You have determined that the present-day fee value of this business to you is \$200,000. Furthermore, you decide that your operating expense on this business would be approximately \$125,000, leaving \$75,000 for acquisition costs and net profit to your department. You may say that \$37,500 is a fair profit, and that leaves you the sum of \$37,500 for acquiring the business.

METHODS OF APPROACH

Having determined the amount you are willing to spend, the next thing to do is to set up a tentative program, keeping in mind your objectives. Direct mail and personal solicitation are, in my opinion, the points from which to start on a limited budget, and if we are to select one of these two, I believe that direct mail is the logical place to begin, for several reasons, among which are:

1. You can select your prospect.
2. You can reach more people than by personal call and reach them oftener.

3. You can conduct an educational campaign among hundreds of prospects while you are calling on a few.

DIRECT MAIL

It is my personal opinion that a well planned and persistent direct mail program should be the starting point in trust development. Lists need not be large to start with, but should be kept up to date and built from all logical sources.

To start with, it is highly important that a central control file be established, in which prospects may be lodged for future reference and follow-up. This file should include prospects from all sources, in alphabetical arrangement, with markings to indicate that the name falls into one of three classes:

1. Inactive
2. Circularization
3. Active.

In the "inactive" class will be placed all names from all sources which may have been subject to investigation and are not logical prospects for any one or more of several reasons, among which may be:

1. Location
2. Amount involved
3. Existing relations with your institution.

In the "circularization" class will be placed all names from all sources which may have been subject to investigation and found to have possibilities worthy of cultivation by mail over a period of time.

In the "active" class will be placed

those prospects to be solicited by special correspondence or by personal calls.

"DEFENSIVE" SELLING

Your defensive sales should take precedence of offensive in the building of a prospect list. You undoubtedly have a central file, showing all the existing customer relationships of your bank. This file should be surveyed and present customers assigned to one of the three classifications which I have just mentioned. Individuals are naturally the first to be considered. Next, you may break down your corporate partnership, or firm accounts into prospects by taking from them the individuals most prominent in each. The importance of cultivating your existing relations first cannot be over-emphasized. Their existing relations with your institution should make them easier of access. If your competitor approaches them successfully, they may be drawn away from you through a seeming lack of interest on your part. With present customers you have a decided advantage in the "closing" value of the already established personal relationship.

"OFFENSIVE" SELLING

When your defensive selling has been planned and put into operation, you may well turn to offensive positions by including in the same prospect files such names as you consider worth following. These may come from many sources, some of which are:

1. Insurance underwriters
2. Lawyers
3. Officials of prominent local corporations

4. Professional men
5. Partnerships
6. Close corporations
7. Large buyers of life insurance
8. Travelers
9. Property owners
10. Beneficiaries of wills.

As I mentioned before, names drawn from outside sources should be properly checked into and absorbed by your prospect file.

Operating with this file as a base, you should class as "active" all the prospects who can be reached by personal calls, and should term "circularization" the rest, who should be put on the mailing list for steady cultivation.

PLANNED MAILINGS

It is obviously impossible to reach as many prospects by personal call as can be reached by planned mailings. May I say now that you should never hesitate to change your letters or circulars when you find that they are not bringing the desired response. Mailings should be planned with a view to advancing the sale to the point where a solicitor can close his case with the fewest possible calls. It would probably interest you to estimate the cost of his interviews by checking the number with his salary. Properly planned and executed mailings will reduce the number of interviews necessary to close business and reduce your acquisition costs, by reason of the fact that the time spent in each closing will be less and that the same number of interviews make possible more personal production by the solicitor.

Continuity is essential to the success of a development program. I can safely say that most discouragement

in this field which has come to my attention has been due to lack of continuity and a definite plan.

Prospects should be followed at regular intervals with letters or leaflets. Each mailing piece should contain a direct invitation to send for a representative or a special booklet. The "pulling power" of each letter or leaflet should be recorded, in order to determine their actual value to your program.

Proper records of the source of all new business should be kept, in order to check and allocate acquisition costs. Lists should be carefully watched and kept free from misspelled names or incorrect addresses. The day-to-day maintenance of files is essential to their efficient use.

PUBLICITY AND ADVERTISING

I sincerely hope that you have not gained the idea that I have overlooked two media which I mentioned earlier, publicity and advertising. Direct mail can and does to a large extent cover both of these approaches. Anything in the way of favorable publicity for your institution and any newspaper or periodical advertising you may do will form a very important background for your trust development program, and these are entitled to their share of credit for such success as may result. In my remarks you may consider that my discussion of direct mail activities has covered to a large extent the advertising and publicity in the earlier stages of "organizing and operating" trust development.

Much remains to be done in this field of trust development, but I sincerely believe that due and proper consideration of the principles I have

attempted to set before you will prove helpful to all who may be engaged in this work, regardless of the size of their own community.

Discussion

EDWIN P. NEILAN (Houston Land & Trust Company, Houston): You mentioned newspaper advertising in the trust business. We have come to the conclusion that the ordinary, may I say, provincial town newspaper is not a very profitable medium of advertising. In New York City you have the "Wall Street Journal" and the New York "Times" and papers that actually get to a prospective clientele, but our experience with newspaper advertising has been rather disastrous as far as immediate results are concerned. What is your opinion on that?

MR. RACEY: News advertising is probably as good a background as you can get in the matter of publicity.

Our own experience has been that we have been able to trace a pretty sizable amount of trust business to news advertising in the last few years. We can, as a rule, trace the name direct to a newspaper advertisement and usually to the newspaper in which it appeared. That had to be followed, of course, by personal solicitation or direct mail as well as by news.

MR. NEILAN: It may be applicable only to Houston but nearly all of the banks have abandoned the newspaper as the means of advertising. They have turned to a weekly magazine called the "Gargoyle." It is modeled after "Smart Set" and it really reaches the type of clientele that is interested in and can afford to indulge in trust business.

MR. RACEY: That gets into the

direct mail field. It is mailed to a selected number. That is the distinction I make. You don't make a mass mailing of it.

MR. NEILAN: No, it is regular subscription; it is an independent magazine.

MR. RACEY: Oh, I thought it was published by the newspapers. Is it local in circulation?

MR. NEILAN: It has a circulation of only about ten thousand but every bank in town is advertising in it. It may be going to a few outside of Houston, but for the main part the circulation is local.

MR. RACEY: The reason we have been able to trace business direct from an advertisement is the experience the solicitors have had time and time again of having the prospect, in the course of discussion, mention that he had read the advertisement and was favorably impressed with our newspaper advertising. That is not a rare but a rather common occurrence. The solicitors have been told not to ask for comment but to report any voluntary comment. It is quite a common report that the prospect has been influenced and has noticed the advertising, whether he has written in or not. On the whole, the business has come from the people who have not written in.

MR. NEILAN: Do you use the daily paper or do you concentrate on the "Times" and the "Wall Street Journal"?

MR. RACEY: I think we advertise in the four or five leading newspapers on a stagger basis.

J. M. EASTON (The Northern Trust Company, Chicago): I am a prospect of yours. How often do you send direct mail to me? I am on your prospect list.

MR. RACEY: I don't know anything about you. Five years ago I might have sent you a letter seven or eight times a year. Now a letter twice a year and a circular or leaflet four times a year would be as often as I would send you advertising.

MR. EASTON: Do you break down your lists to certain kinds of prospects, prospects for living trusts, women of wealth, or agencies?

MR. RACEY: They are classified into firms, individuals, corporations, women, and so forth, according to certain locations in the city.

MR. EASTON: Do you have a different sheet for each group?

MR. RACEY: Yes. We have one list, for instance, which is distinctly a prospect list for close corporation insurance. Each man is an official of a close corporation in the city. We have another list which we compiled and just got into operation last fall, a list composed of individual members of stock exchange firms. We thought probably they should be making voluntary trusts along about that time. I can't give you the experience on that.

JOHN D. LONERGAN (Title Trust & Guarantee Company, Johnstown, Pennsylvania): Do you classify by profession?

MR. RACEY: We classify according to certain lines of business but not professions. We use certain lists in the case of physicians. We select the custodian and voluntary trust solicitation prospects.

MR. LONERGAN: What about members of the bar?

MR. RACEY: We do classify with members of the bar. We have not used the list as Mr. Dunham has. We have done such things as this, for instance. Last month a new state tax

law passed in New York State. Our tax man was in Albany and knew exactly when the bill would be signed. We had a copy of the bill set up, had the envelopes addressed and ready for distribution. The bill was signed at about eleven o'clock in the morning and there was a printed copy of that bill, with our compliments, in the mail at eleven o'clock that night, going to every lawyer in the three boroughs. It was something they were vitally interested in but wouldn't get in the regular way under six weeks. We have that special list which numbers about 12,000.

ESTHER L. WIEST (The Michigan Trust Company, Grand Rapids): Do you believe there is any chance of closing a prospect without any previous contact?

MR. RACEY: I have had that question asked me a great many times. Fortunately, we have not had to do much of that. It depends on the salesman himself in calling on a cold prospect. If he is a man who can get *entrée* and interest the prospect, it is as well that he should not wait, but I think it should be part of the duty of every trust development department to provide the solicitor with leads so he can be more productive through having leads for those who are acknowledged as good prospects.

BLEECKER WILLIAMS (Peoples Trust & Guaranty Company, Hackensack, New Jersey): What do you think of the practice of using reply cards?

MR. RACEY: I am keen on using reply cards and coupons because they facilitate response to the direct mail advertising. I am particularly keen about the business reply envelope. I think that is quite a good aid in the development of direct mail.

MR. REIBER: What is the percentage of those card returns?

MR. RACEY: I have had some mailings show a return of 3%. I have had one that showed a return of 65%. I should say that the average was about what the last mailing of that kind showed, about 11% return.

MR. REIBER: What percentage of prospects do you get from that return?

MR. RACEY: You mean the business closed as a result of that reply card?

MR. REIBER: I think one of the other speakers touched on that.

MR. RACEY: I can't tie that in with the direct response, but I can say that in the last five years 91% of the trust business we have closed has been contacted by direct mail and advertising. For a five year period I think that speaks very well for the advertising and direct mail. All of this business has been closed by personal solicitation, with one or two exceptions.

Some one asked about actually completing business by direct mail. I had one outstanding case of that kind which shows the value of keeping records. We had made mailings for about ten months and the records showed the response was due for a follow-up two to four weeks after the response had been received. Before the follow-up was made, this man died. We found that two days after he had responded to a direct mail piece, he had executed a codicil to his will naming us as executors and trustees under the will. It was almost a set-up because the estate amounted to a little under three million dollars and there had not been a personal call made.

JOHN W. KRESS (Howard Sav-

ings Institution, Newark): Do you consider that personal solicitation procures more business than leaflet or booklet advertising?

MR. RACEY: Leaflets can be more outspoken and can be made more attractive through the use of layout and colors. Too many letters, I think, are apt to throw the prospect out of the prospect list. I think short letters and very terse and well prepared leaflets can be used to advantage; I should say about four, or at least, three, leaflets to one letter. We have always used leaflets as leads for booklets and I don't know that we have ever sent out a booklet direct unless we want to clean up our supply of booklets when new ones are coming on. We always send the least expensive and very brief description of what the booklet contains and in that way get the coupon. Then we can send them the booklet, which is probably more expensive and will take more time to read.

MR. REIBER: How many pages do you usually have in the leaflets and how many in the booklets?

MR. RACEY: That varies. The leaflets are usually four pages, that is, just one fold. Sometimes we get them out larger. Sometimes the booklets run twelve to twenty pages.

MR. EASTON: Suppose you have a list of prospects that are obscure and you don't know who they are. Do you ever call for a show-down, asking them, "Are you or are you not a prospect?" and in that way get them off your lists?

MR. RACEY: We have not done that for three or four years, but we figure that every inquiry from news advertising costs so much. If we get one hundred inquiries from a \$600 insertion, we figure there is a six dol-

lar cost on each of those inquiries. We immediately check against the records to learn if we can determine who the person is and whether he is of any value as a prospect. If we determine he is valuable, we put him in the active class. We may send some one around with a booklet, if the prospect is close enough for a call. We send a man who is being trained in trust solicitation as a messenger. He gets an idea of what kind of business the prospect has and what the situation is.

The first clean-up we used was a reprint from one of the New York papers which stated that there were thousands of uncalled wills of people who had probably died, but their wills were stored in envelopes and had been accumulating. We reprinted that, with a message on the leaflet calling attention to the fact that if

they had named us in their wills and had not notified us, we would be very glad to put their wills in safekeeping, free of charge; we enclosed reply envelopes so that they might tell us whether or not they wanted to do this.

Another time we sent out a leaflet saying, "We are being persistent about this," and asking them if they had done anything about this or intended to, or whether they wanted information. We got about 35% response on that. I think there were fifteen who came in and said they had named us but had neglected to notify us. There were several hundred who said they wanted additional information on one or more of the services of the trust department. It was quite worth while.

I think the clean-up is a good thing to use.

How to Write Effective Copy

By FRANK FUCHS

ADVERTISING MANAGER OF THE FIRST NATIONAL BANK IN ST. LOUIS,
ST. LOUIS, MISSOURI

Address before the Denver Departmental Conference

Who would want to drive a horse and buggy on a road crowded with Fords and Buicks? And yet banks use cut and dried financial copy, consisting of several paragraphs, that appear in newspapers and other publications literally jammed from cover to cover with attractive advertisements of every description.

Advertising copy must accomplish three objectives: first, it must attract attention; second, it must create interest; third, it must get action.

The elements that secure attention in advertisements are usually headlines and illustrations. If these two elements are well conceived, they will lead the reader on to find what the advertisement is all about. Creating interest depends largely upon the kind of copy used, and how it is written. In order to get action, the advertisement must appeal either to reasoning power or to suggestion or to a combination of the two. People, as a rule, are more susceptible to suggestion than they are to reasoning.

Mr. Fuchs explains the need of bank advertising in this paragraph: "The bank has passed out of the period of its narrowly limited usefulness. It has indeed become a department store of finance. It carries a line of service ranging from savings accounts to steamship tickets. Let us not forget that a bank lives by the sale of service and credit. The bank of today has assembled services which are made convenient to the public; yet the bank that does not sell its various services to the public through constructive and attractive advertising can hardly expect the public to use those services."

I HAVE been asked to talk to you on the subject How to Write Effective Advertising Copy, which is quite a difficult assignment, because there seems to be much difference of opinion among bankers as to what kind of copy really is effective for their particular institutions.

Before going into "effective copy writing," let us first consider what financial advertising copy, or any advertising copy, should be designed to do.

PURPOSES OF FINANCIAL ADVERTISING COPY

Generally speaking, financial advertising copy, regardless of what medium is used, should be designed to do three things: first, to attract attention; second, to create interest; third, to get action. A bank advertisement prepared only to attract the initial attention of the reader, and failing to get his interest, has left an important amount of work unfinished, at the very start. If an advertise-

ment starts the reader on a train of images toward a desired result, and then introduces irrelevant ideas, the interest will be killed immediately. The elements that secure attention in an advertisement are usually the headline (sometimes subheads) and illustration. If these two elements are well conceived, they will lead the reader on to find what the advertisement is all about.

ATTRACTING ATTENTION

Headlines are usually short, containing four or five words, in bold display. Illustrations are frequently referred to as the "show window" of the advertisement. They usually consist of photographs or pen drawings. Most people see a picture before they see a word, and the picture language is universally understood and is grasped more readily than the printed word. Decorative designs are also used frequently to lend attractiveness to the advertisement. A great deal could be said about headlines and illustrations, and no doubt these will be discussed by other speakers on the program this afternoon.

CREATING INTEREST

After getting the advertisement seen, the next thing to accomplish is to get the advertisement read. This depends greatly upon the kind of copy used, and how it is written. The first problems of the advertiser in determining the style of copy to adopt, are to discover just what he expects to accomplish with the advertisement, and then to select the proper type display that will harmonize with the product or service advertised.

A great deal of advertising matter which is interesting in itself, fails to get attention because the type is difficult to read. Type must not only be pleasing in appearance, but must be decidedly legible. The type size and style should be made to emphasize the important matter, and to subordinate the less important part of the text by variation. An advertisement that employs type which emphasizes too many things, is of course not easily read and understood, because the eye and mind are confused.

When selecting type for your advertisement, do not violate any laws of good taste. Many of the large banking institutions leave the matter of typesetting entirely to experienced typographers who specialize in this particular kind of work. This is good practice.

DETAILS IN CREATING INTEREST

The sentence structure of the advertisement must be such that the message is quickly grasped. The ideas must be simple. They must be well arranged and must be vividly presented. All of us like to avoid the labor of useless thinking, just as much as we like to escape avoidable physical drudgery. Simplicity of language creates clearness. There must be no doubt as to what is meant. Errors of number in nouns and verbs, the omission of the necessary apostrophes, disagreement of pronouns, the misuse of adjectives or adverbs, improper tense sequence, and other errors are inexcusable. Words in the advertising message must be accurate and appropriate. They must express what the advertisement writer has in mind; they must convey the same idea to the reader; they must impress the

reader so that he will accept the ideas featured in the advertisement.

If the writer of an advertisement is not sure of what he wants to say, he is vague. If he has not a sufficiently extensive vocabulary to say what he wishes to say, he is obscure. That is the reason why some advertisements do not prove very productive of results. They represent just so much type crowded into so much space, at the bank's expense.

Various forms of copy are employed by financial advertisers. They include the argumentative, the descriptive, and the narrative forms. Many institutions also use the educational form of copy—copy that tells the reader exactly why a certain bank service is of value, and how to use it to the best advantage. Some use historical copy exclusively. Other institutions, generally speaking, use the narrative form of copy in their advertisements, because they feel that this form of copy has more attention and interest value than any other form. This may be true to some extent, because people are fond of stories, and an advertisement that is dramatic in its appeal has perhaps a better chance of being read than a dry recital of facts. Under the dramatic form may be classed the incident, the monologue, the dialogue, and the story.

Length of sentence is an important matter to consider when writing copy. The eye has its own peculiar construction, which permits it to perform its functions easily within certain limits, but with increasing effort beyond these limits. If the eye finds that the length of sentences is such that it requires the maximum of effort to focus upon them, it will turn away and select the advertisements which

will allow it to function more readily.

It is estimated that to hold the reader's attention, the average sentence should not exceed twenty-five words. Variations, however, are permissible. The skilled and experienced advertiser sees that his copy is coherent throughout, that his facts and purposes stick together. He arranges facts in the order in which they occur; he arranges his material so that the ideas follow one another in natural sequence to a climax. When the advertiser has chosen the material for his copy, he should see that it is not all of equal importance. Emphasis should be given to the important points. Advertisements that begin and end weakly, with material of minor importance, fail to make a clear impression and to get maximum results. Copy that is arranged and written so as to be in harmony with the thought, and with the medium in which it is presented, is easily grasped. If it is started in the "ginger style," this must be maintained throughout. If it opens seriously, the same tone should be maintained. If it is started in a confidential, heart-to-heart style, this should be kept up to the close.

GETTING ACTION

Now the advertisement has been seen and read, and the next thing to accomplish is to get action. Human nature is not so difficult to analyze as it was thought to be in the past. People reach decisions by one of two methods, or by a combination of the two: these methods are reasoning and suggestion. People, as a rule, are more susceptible to suggestion than they are to reasoning; consequently, action is produced through suggestion

more frequently than through reasoning. An advertisement should generally make an appeal to the emotions, even though it contains "reason why" copy.

A person who reasons is one who has a store of definite purposes and who does not decide on an action until he has ascertained whether it is in line with these purposes.

So much for the three essential things that I believe financial advertising should do, no matter what medium is used; and a brief account of how to do them. Hours could be spent in discussing these necessary steps, owing to their importance, but I must go on and try to tell you more about writing effective copy, especially in our present day and age. The fundamental principles outlined are the same today as they were three thousand years ago when the first advertisement was written, but the make-up and text are entirely different, as I see it. Who wants to drive a 1920 Buick today?

A REVIEW OF FINANCIAL ADVERTISING

First, let us digress for a moment and review financial advertising. In the beginning it was an accident. It was an experiment of some men of an adventuresome turn of mind, who were not taken seriously in the banking business. Then it gradually became a fad, indulged in by bankers who applied it because others did. Then, gradually, specific advertising was used for specific purposes. Copy began to be written for the purpose of doing certain things. Purpose took the place of guesswork, and that brings us to the point where we are today, 1930 models.

The bank has passed out of the period of its narrowly limited usefulness. It has indeed become a department store of finance. It carries a line of service ranging from savings accounts to steamship tickets. Let us not forget that a bank lives by the sale of service and credit. The bank of today has assembled services which are made convenient to the public; yet the bank that does not sell its various services to the public through constructive and attractive advertising can hardly expect the public to use those services.

A BANK'S ADVERTISING MUST REFLECT ITS PERSONALITY

Of course many of the large institutions have been successful in this effort, but I believe that the waste of many thousands of dollars would be avoided if more banks recognized the necessity for more effective advertising copy.

Now you may wonder just what kind of advertising copy is most effective for a bank to use. Naturally, that depends a great deal on the institution, the kind of service it renders, and the class of people it is reaching.

No two people are exactly alike, and no two banks are exactly alike. Every bank has a certain personality; it maintains certain ideals; it has definite policies. The bank's advertising should reflect these things, clearly and consistently; yet many bank advertisements, especially newspaper advertisements, are practically alike. Very few are distinctive, individual, or different. Take a dozen bank advertisements out of any large city newspaper, cut off the signatures, and you cannot, to save your life, tell one from the other.

That is one weakness of financial copy and perhaps the reason why some bank advertisements are unnoticed by the reading public. Another serious weakness is the large amount of copy set in many different type faces and sizes, and crowded in various sizes of space from one-eighth of a page to a full page.

ADVERTISING MUST BE MODERN

I honestly believe that too many banks are producing advertising copy today that appealed years ago, unmindful of the fact that the average twentieth century American who has long discarded the horse-drawn vehicle and the bicycle, seldom reads cut and dried financial copy, consisting of several paragraphs, that appear at regular intervals in sixty- to eighty-page newspapers and two-hundred-page publications, literally jammed from cover to cover with attractive advertisements of every description.

Recently, I received a large folder from an advertising concern, featuring many reproductions of newspaper advertisements prepared by both large and small financial institutions located throughout the country. These advertisements were sent at a small cost, to give me an idea of just how some banks are advertising in their local papers. Looking through the folder hurriedly, and that is the trend of the times, I wondered just how many of these advertisements were really carefully read and how many received just a passing glance from the reading public, and failed to register. With some exceptions there was nothing new or different to be seen. Most of the copy, no doubt, was prepared to suit the bank, or the vice president in charge of advertising, and not the

man in the street. Threadbare ideas and theories are a bit out of place just now. The copy that worked yesterday may not work tomorrow; we must adjust our ideas and copy until they are thoroughly adequate to do the job, to stand the strain of the new way.

How many of you read the advertisements in your local newspapers just before coming to this convention? Which advertisement impressed you most favorably? Was it the advertisement consisting of the usual several paragraphs of copy, crowded into small space, or was it the advertisement with the old message told in a sparkling and new way in a limited number of words, attractively set up in a substantial amount of white space? Perhaps at this moment you cannot recall any particular advertisements, because they failed to attract and hold you. Probably you were too much concerned about the headlines and news items on the front page, or items of interest on the sport page; or maybe you got a "kick" out of the comic page, or market reports. After reading that portion of the paper giving you a treat, a thrill, you hurled the paper aside, and other matters of importance and personal interest occupied your time and attention.

THE ADVERTISEMENT MUST HAVE "PUNCH"

A very interesting article appeared some time ago in Harper's Magazine, entitled *This Hard-Boiled Era*. The author tells us that the twentieth century American is no longer interested in the art of boxing, but wants a "knockout," a thrill! How about the art of advertising? Isn't the principle the same?

Dempsey was popular with the public because he had a "terrific punch," which gave the fight fans a knockout. It is that punch, that "something different," that makes advertising and everything else, popular with the hard-boiled American of today. And so it is to a certain extent with so-called threadbare financial advertising copy. It must have a "wallop," easily caught and easily understood; must be something different, novel, unique, and yet sane and sound, to attract attention, create an interest, and get definite action.

We are hurrying here and there, using every means to reach our destination as soon as possible, just to be able to go elsewhere. En route we find advertisements everywhere, attractive, short, snappy, to catch the prospective customers "on the fly." But the banks—not all of them, but too many of them—are still in the horse and buggy age, with their advertising copy. It lacks that punch, that "something different," necessary to make the average individual sit up and take notice. Take the modern theatre, the stage shows, the talkies, the radio program, in fact entertainment of all kind, and what have you? Just one thrill after another. Seldom anything sombre, dry, or slow. Some one has said that this is a jazz age. Perhaps that is true. The intellectuals and the gentlefolk seem to admit it. I know that the public is air-minded and speed-mad. We cannot deny that.

Therefore, if the banks are going to "cash in" on their advertising, they will have to "step on the gas," keep abreast of the times, and give the twentieth century American something new and different in financial advertising copy.

The first step in this direction, I believe, is to cut down the length of the copy more than half, increase white space, and set up the type in such a way that no one can miss it; the advertiser must compete with the headlines if necessary. He must stop the reader with his advertisements. He must be different. He must have a creative mind; unless he has that, he should get out of the advertising profession.

So much for newspaper copy; the same applies to booklets and folders, generally referred to as direct mail advertising. Booklets and folders serve a definite purpose. Primarily, they serve to answer questions and explain the bank's services usually suggested in the limited space of the bank's newspaper advertisements. But do not prepare a ten-, twelve-, or eighteen-page booklet, and expect your prospect to read and digest it. He will not do it. If he wants to read a book he will buy one or go to the library and get one. You cannot expect people who will not read your newspaper advertisement containing several hundred words in three, four, five, or more paragraphs, to read a long-drawn-out piece of direct mail advertising. They will pass you by surer than scat and look for something more interesting; isn't that human nature?

BOOKLETS ARE INTENSIFIED SELLING TALK

Booklets and folders should present, in as concise form as possible, the various selling points of the service offered, in order to make it easy for the customer to read and understand and become interested in the service or services featured.

In other words, direct mail advertising is intensified selling talk, the bank's specialty salesman. The skilled advertiser therefore holds to simplicity, because he knows that simplicity is most effective; the unskilled advertiser cannot hope for success if he violates this rule.

The color for the stock used in booklets and catalogues should be considered carefully, because this adds greatly to the attractiveness of the material, and reflects the personality of the bank. The typography should be simple and dignified, and, of course, very legible.

"Inspirational" style of copy is peculiarly fitted to a booklet, but a folder is usually used to fill in any niche in the bank's advertising program. The folder's greatest value lies in focusing the prospective customer's interest on some distinct service. Hence, there is a definite and relatively restrictive field for each, and I have touched upon them just briefly, because I believe that this phase of the advertising manager's work is very closely related to writing effective copy.

If the copy is effectively written, but improperly presented, it is obvious that the results will not come up to expectations.

BREVITY; ORIGINALITY; CONSTRUCTIVENESS

In conclusion I should like to leave these two thoughts with you, because you may have occasion some day soon to write advertising copy for your institution.

1. Do not forget that our manner of life is more rapid, more varied, and more efficient today than ever before.

2. It has become increasingly evident that the average modern mind is considerably overfed, and unable to analyze and organize all it has acquired. You do not help this weakness by crowding all the copy you possibly can into a small advertisement, booklet, or folder, requiring considerable time to read and digest.

Therefore, when writing copy, try to be brief; try to be original; try to be constructive.

Discussion

STEPHEN J. SPELLMAN (Lincoln Alliance Bank & Trust Company, Rochester): Mr. Fuchs, I believe you mentioned in your interesting talk that you received samples of bank advertising from a company here in the West. I wonder if you would mind giving me that address.

MR. FUCHS: I knew that question would be asked and I am sorry I failed to get the address. If you will give me your address I will forward you the folder I had reference to.

MARK BARTLETT (Hibernia Bank & Trust Company, New Orleans): I received from the St. Louis Star, I think it was, a reproduction of a full page advertisement the theme of which was "Old Man Sunday Circulation Is on the Toboggan." I notice you use full pages and naturally you must give considerable thought to gaining attention. I should like to hear from you what your opinion as an advertising man is regarding Sunday circulation.

MR. FUCHS: The reason you received that circular is that there has been quite a battle waging in

our town between a daily paper that has a large Sunday circulation and the particular paper you mentioned, which has no Sunday circulation at all. Personally I am not in favor of Sunday circulation. I think that opinion is shared throughout our entire institution. The Sunday paper, as a rule, contains so much reading matter and so many other things to attract the reader's attention that I am inclined to think an advertisement in the Sunday paper receives no attention. People are in no frame of mind to think about banking. They have the magazine and sport sections to read, and especially during the summer months, they are probably away either for the day or the weekend.

Another objection is that the rates on Sunday are higher than the weekday rates. We use nothing but weekday papers, including Saturday, and then only when we can get the back page. Sometimes on Monday we cannot get the back page and then they hold it for us for Tuesday. We run a full page advertisement once a week in one of the four dailies, the Post, Star, Times, and Globe, but only when we can get the back page. We feel that position is more effective than the inside. The advertisement stands alone; there is nothing to detract from it on the opposite page and it is unusually good poster advertising.

Personally, I am not in favor of Sunday advertising.

WILLARD G. BARKER (Morris Plan Bank, Washington, D. C.): I believe you said that one should bear in mind in writing copy that the public is not going to read it and if they did, that they wouldn't believe it. I wish you would clarify that.

MR. FUCHS: The old saying goes that bank advertising is a waste of money and that nobody reads bank advertisements; that one bank is the same as the other, that it has nothing more to sell than another. What I meant by that was that when you write an advertisement and make up your layout, your illustrations, and everything that goes into it, ask yourself the question, "Will people read this advertisement?" If you are in doubt about it, of course it is your job, then, to rearrange it and rewrite it in such a way that you think they will read it.

Get away from sameness. I think too many of the bank advertisements are alike and that is the reason they are not read, as I tried to explain, but when you try to answer that question in writing copy, I think you will get a very attractive and effective advertisement. Write an advertisement that they are bound to read; write an advertisement that they are bound to believe; something that will stop them.

I don't know whether I have made it clear. Does that answer the question? In other words, after you have completed the advertisement, ask yourself the question, "Will they read it? Will it stop them?" If you don't think so, throw it away and write another advertisement. Even if you have to write three or four or five or six before you get the advertisement that will accomplish the thing you have in mind, it will be time and effort well spent. Be individual and distinctive.

MRS. JOS. M. BREWCZYNSKI (Peoples Trust Company, Little Rock, Arkansas): What do you think of the department store style of advertisement that the Union

Trust of Cleveland and some of the others are using, with editorial copy and sometimes half-tone photographic cuts?

MR. FUCHS: Personally I am not in favor of it. I may be wrong. I do not believe anybody is going to read an advertisement that takes very long to read. It is estimated that the average person takes fourteen minutes reading the morning newspaper, and I doubt whether he spends that much time. People look for the department store advertisement because there is usually a bargain in it for them, something they can buy reasonably. They skim through the advertisement until they find something that appeals to them both in material and price.

I think bank advertisements are quite different. The average person is not attracted to a bank advertisement. He thinks it is some more "hooley" and that one bank has no more to sell than the next one, and so passes it by. That is the reason I submitted these full page advertisements that I have here. I think if you have a very attractive illustration that hits them between the eyes, they will stop and say, "What is this?" Then when you have them stopped, give them eighteen or twenty words with your message. They will read them and digest them, but I think an

advertisement that has several paragraphs of copy will be passed by because nobody has or takes time to read them.

How many of you would take seven or eight minutes of your reading time to read a bank advertisement? I do not think it is human nature to read a bank advertisement, particularly if it is long.

MRS. BREWCZYNSKI: Do you keep in touch with the Marine Trust Company advertisements; what do you think of that style?

MR. FUCHS: I do not want to pass judgment on that.

MRS. BREWCZYNSKI: I mean where half-tone cuts of customers and real news story items are used.

MR. FUCHS: I think some of it is all right if it has human interest appeal. However, I don't like to pass judgment. All styles are good; some are better than others. In my years of experience in this particular profession, I am inclined to believe that the more banks cut down on copy and increase the space, the better chance they have to get the copy read.

I think the Continental-Commercial of Chicago uses a quarter page advertisement with ten or twelve words in the center. Some of the leading banks and financial advertisers are doing the same thing.

How to Build an Advertising Budget for a Bank

By PRESTON E. REED

EXECUTIVE SECRETARY OF THE FINANCIAL ADVERTISERS ASSOCIATION,
CHICAGO, ILLINOIS

Address before the Denver Departmental Conference

There is no slide-rule method by which to determine the amount of the advertising appropriation. Each bank presents an individual problem, and the problem of each bank must be decided separately.

Mr. Reed believes that in order to plan an advertising budget for a bank, one must first analyze the bank's services and functions; then decide what must be done to increase the volume of the profitable activities and to eliminate or minimize unprofitable services; and, last, put together all the facts so as to plan an advertising and sales campaign which will produce profitable business at a reasonable cost.

What per cent of the total budget is to be spent on each different advertising medium is again an individual problem for each bank. Mr. Reed presents an average of scores of budgets and also one actual budget, which may help in solving this problem.

Mr. Reed does not favor the allocation of advertising expense to the type of service featured in the advertisement, but instead would leave the whole matter in the hands of the advertising manager.

AN advertising budget for a bank, which will be worthy of consideration must of necessity be a tailor-made job. If you walk up two flights of stairs to get an extra pair of pants free, you can expect just that kind of budget. Imagine a tailor trying to make a suit to fit the wearer if he had no measurements. Of course, most suits have coats, trousers, vests, sleeves, pockets, buttons, and so forth, but a suit that would fit Paul Whiteman would serve as a tent for a man of average size.

The advertising man starting out to build a budget is confronted with the same problems as the tailor. Of course, there will be commercial pants, savings coats, foreign vests, and safe

deposit pockets to be worked into the finished product. But, unless the budget tailor has the proper measurements, the result will be an ill fitting garment.

The first difficulty lies in ascertaining the proper measurements. After these have been determined, then the real problem has just been approached. Just as a suit proclaims to the world something of the character of the man, so does a budget, when put into operation, determine, to some extent, the public's estimate of the character of the institution being advertised.

This brings us to the next question to be considered, the conflict between necessity and desire. Just as any man

(budget considered) must decide whether he shall spend the money available for clothes on a wardrobe consisting of apparel for all possible occasions or on one consisting of a few outfits of good material for the occasions he knows are absolutely necessary, so must the advertising man decide the conflict between desire and necessity in building his budget.

Planning an advertising budget for a bank is a matter of analysis, interpretation, and synthesis.

1. Analysis—taking apart, separating into component parts the bank, its services, and functions.
2. Interpretation—a study of these various parts to determine what must be done to increase the volume of the profitable activities and to eliminate or minimize unprofitable services.
3. Synthesis—the intelligent putting together of facts found from the analysis and interpretation so as to plan an advertising and sales campaign which will produce profitable business at a reasonable cost.

ANALYZE YOUR PRODUCT

In making an analysis, it is necessary to find out not only just what services your institution has to sell but what part of those services are profitable and what part are unprofitable. Then you must discover what are the advertising possibilities of each of these services. This will take careful thought. You must decide whether or not you are going to advertise savings for all the banks in your competitive market, or whether you can discover just what individuality the savings department of your bank has

to advertise. Some banks are altruistic to the extent that they are willing to spend money on educating people to save, without regard to whether they themselves get the savings deposits or their competitors reap the benefit.

ANALYZE YOUR COMPETITION

Analysis of your product does not complete your study. You must also analyze your competition. Just how much business is in your territory? How much will naturally gravitate to your bank, and why does it naturally flow to you instead of to your competitor? How much business will you have to go out and secure? How much competition will the other banks in your territory offer? What media are available, and just how much or how many times must you appear in the various media to meet the competition?

After you have analyzed the various advertisable services of your institution, after you have decided just what services must be stimulated by advertising, and after you have ascertained the nature of your competition, then you must determine how best to advertise profitably to the greatest number of people in your trading territory. It is assumed that the functions of all the different kinds of media are known, that the advertising manager has a knowledge of how to tie in the various media so that they will supplement each other. It is not a matter of setting down in black and white how much and what kind of advertising is going to be used to sell these services or departments which have been previously analyzed. When these have been itemized, carried forward, and the total set down,

you have, to be sure, a workable advertising budget; but this perhaps will not be final. Your actual advertising budget will be a compromise between desire and necessity. It is a compromise between the ideal thing to do, as outlined by the advertising manager, and the thing which really can be done, as determined by the willingness of the finance committee of the institution to appropriate the required funds.

CHOOSING THE ELIMINATIONS

Returning to the tailor-made job, it may be that you will have to eliminate from your wardrobe an afternoon frock suit. It may be that some of your coats must be lined with satin instead of silk. Perhaps you can't have a golf suit with long trousers and knickers; you will have to buy the knickers separately and get a sweater to match. In pruning down the advertising program to meet the advertising budget, however, the advertising plan must not be disturbed. It may be curtailed here and there but the general plan and outline should be followed consistently.

Planning the advertising budget is one of the most important jobs that the advertising man has to do. When planning the budget, he must thoroughly analyze the institution, its services, and the market, and then lay out the campaign for the year. With this once done, it is easy to avoid trouble with various department heads, who might have a tendency to be sold on the fly-by-night ideas which have been so convincingly offered by high pressure salesmen.

Contrary to what was a generally accepted idea five or ten years ago, let us assume that every bank has its own

personality and is individually different from all other banks. If this premise is true, then it follows that the advertising plans for banks are, of necessity, different, and, moreover, it is futile to search for a yardstick with which to determine what should be spent by a bank for advertising.

NO SLIDE-RULE METHOD OF APPROPRIATION

Let us recognize right now that there is no slide-rule method which will determine the amount of the advertising appropriation. It is like asking, "How long should a bridge be?" without knowing the width of the span.

Through research we have learned how much, on the average, the banks are spending for advertising. The average amounts may be too much or they may be too little for the individual institution. Up to a few years ago, only a few banks had any plan for arriving at what should be spent. The main object seemed to be to find out what the competing institutions were doing, or what other banks of similar size were spending; then the advertising manager would strive to get as much as he could, and the finance committee would allow as little as possible.

THE PERCENTAGE BASIS

It is true that many bank officials would like to use and some still do use a percentage basis, which has been found, after careful research, to be the average of what a great many banks are spending. Three percentage bases have been arrived at as the average which banks are spending. They are as follows:

1. 1% of the capital and surplus of the bank
2. $\frac{1}{10}$ of 1% of deposits
3. About 5% of the gross profits.

Knowing the amount spent for advertising, it is easy to find the percentage based upon capital and surplus. The average, over the country, as stated above, is 1%. Many large institutions have a relatively smaller capital and surplus than banks half their size. How absurd it would be for a bank with a very large capital and surplus to base its advertising appropriation on $\frac{1}{10}$ of 1% of the deposits, if the deposits were not in reasonable proportion to the capital and surplus. The same is true when a bank of small capital and surplus and large deposits bases its advertising appropriation on 1% of the capital and surplus.

Let us consider the second method, that of basing the advertising appropriation on deposits, the average being about $\frac{1}{10}$ of 1%. Just to prove the fallacy of this method, we may work out the resulting appropriations of a few banks. One of the world's largest banks, located in New York, would spend \$1,649,544, which is more than would be spent by the largest bank in all of the following cities combined: Cleveland, St. Louis, Detroit, Buffalo, and Pittsburgh. Such appropriations, of course, are probably all out of proportion.

The third plan, that of using 5% of the gross profits for advertising, is equally absurd, as a guide to all banks. A \$20,000,000 bank making 7% gross profits is much more in need of advertising than is a \$20,000,000 bank making 20% gross profits. Again, let us reiterate that there is no one logical or satisfactory percentage basis which can be

used to determine the amount of all bank advertising appropriations.

EACH BANK A DIFFERENT PROBLEM

Well, then, just how is a bank to know how much should be spent on advertising? It is a very simple, logical question, and easily answered. A Cleveland bank advertising man has summed it up in the following statement:

"No advertising appropriation worthy of a name can be arrived at without a thorough knowledge of what the financial house has to offer, to whom it has to offer, through what mediums it is going to offer it, and the key-note of the copy to be employed. All of the above are in turn merely reflections of the problems of the individual financial advertiser and the goal he seeks to attain."

A Detroit bank advertising manager has commented as follows:

"First, select the theme or main thought which shall run like a scarlet thread through all the advertising. Second, decide as to the main objective which should be reached through the advertising. The considerations which come under this heading are numerous. For instance, you must consider:

- A. How much institutional advertising can be done
- B. How much advertising is needed to support the efforts of each main department of the business
- C. What departments need extra attention to create definite momentum for them
- D. What particular groups you have in mind upon which you particularly desire to concentrate."

A Boston advertising manager says:

"Be pretty fairly acquainted with what you have to sell, who buys it, and what makes him buy it. Like every manufacturer, you are concerned first in producing a good product, but your greatest problem continues to be in selling it to the customer. If the finance committee approves of the scheme laid down, you are given sufficient appropriation to do the job as it should be done, regardless of the relation of that sum to deposits, capital, and surplus, or profits, as the case may be."

A Southern banker says:

"Each bank will have a separate problem to face based upon the relative position of dominance of the market of the bank planning the budget, and the amount and nature of advertising used by competitors. I do not think it is practical to arrive at the amount of money to be spent for advertising on any percentage basis, but rather by considering the individual bank, the market, and competition, the particular problem the bank wishes to put over, the logical media for accomplishing this most satisfactorily and economically."

A New York banker says:

"Advertising should not be based on relation to resources or expenses, but rather on the possible business that can be secured and what it is worth after it has been secured."

A BUDGET ARRANGED BY MEDIA

From these statements made by successful executives who are considered authorities in their profession, we can conclude that the first job in planning the advertising appropriation is, as originally emphasized, one of analysis.

After you have completed the analysis of your institution's services and have arrived at the sales appeal, then

the method and the media you are to use in advertising these services can be set down in black and white, with the cost of each item. Their totals will give you the ideal advertising budget. From this detailed breakdown there can be compiled a budget, arranged by media, to use as a working schedule during the year.

Just as there is no universal percentage yardstick to determine an advertising budget, neither is there a percentage basis upon which an individual institution can determine the amounts to be spent on various media. The following is a list of media and the per cent of the total advertising budget spent on each. This is a mean average of scores of budgets:

40 %	Newspapers
17 %	Direct mail
14 %	Outdoor
7 %	Window and lobby displays
4.5 %	Financial publications
4 %	Advertising specialties
2 %	Car cards
2 %	Mass plan
9.5 %	Miscellaneous.

Compare these percentages with that of an actual budget of one of the most progressive bank groups (and perhaps one of the most efficiently advertised). Certainly the detailed care with which the budget program is presented in its original and complete form indicates a comprehensive and analytical knowledge of the situation.

AN ACTUAL BUDGET

BY MEDIA	
Outdoor advertising	18.00%
Daily newspapers	17.39%
Window display	10.40%
Salaries	9.50%
Printed matter	9.00%
Our percentage of bank overhead	6.90%

Art work	6.50%
Engravings, mats, and so forth	5.20%
Miscellaneous	3.02%
Direct advertising	2.80%
Calendars	2.20%
Local magazines	2.10%
National financial magazines	2.10%
Out of town newspapers	1.80%
Rent	1.70%
Local directories	.70%
National directories	.60%
State financial magazines	.04%
Bulletin boards	.03%
Gift advertising	.02%

In this budget you will note a considerable variance between the per cents of appropriations spent for different media and those of the average budget.

First, newspapers, in the average budget, take first place, with 40%; whereas in this actual budget they are in second place, with 17.39%. Outdoor advertising in this budget is 18% and stands first, whereas in the average it is in third place with 14%.

It must be remembered that a definite detailed budget must be subject to revision during the year. No advertising manager can see months in advance all the special opportunities and contingencies which may arise. For instance, during the past few months one midwestern bank was so fortunate as to have the opportunity of publishing a book of national interest written by its president. The book cost over \$3,000; this item could not be foreseen. Letters from the country's leaders, however, indicate that the value in good will and institutional recognition was worth many times the actual cost.

SHOULD THE BANK'S ADVERTISING BE CHARGED TO THE VARIOUS DEPARTMENTS?

There is just one more point of in-

terest which should be mentioned. Should the bank's advertising be allocated and charged to the various departments?

In answer to this question, one of the leading authorities in the East replied:

"It has always seemed to me that advertising should be considered a charge against the profits of the institution, without regard to the departments which earn them. Most auditors, of course, like to charge all of the advertising which mentions the trust department to the trust department, and deduct it from the department's earnings. This is extremely difficult, especially in the case of an advertisement which mentions several departments, and in my experience always leads to endless arguments: first, from the man who doesn't think you are spending enough money for this department, and, second, from the man who thinks you are spending all of his earnings. I am very much in favor of the policy which makes no attempt to allocate these charges but leaves the whole matter in the hands of the advertising manager, who, of course, is directly under the control of the president."

Another banker says:

"The allocation of expense to the type of service featured in the advertisement is, in my case, merely a device used in my own department to enable me more intelligently to apportion correctly what we have to spend among the services we have to sell. I get a definite advertising appropriation each year from the bank, and by the grace of God I stay inside of it. What that appropriation is eventually charged to is a matter of bookkeeping in the auditing department and no worry of mine. I think it would be ridiculous to try to use a departmentalized system of charging off advertising, in the case of advertising such as ours, which is largely institutional instead of departmental."

It seems to me that the allocation of the various items of the advertising budget will be decided by the auditing department of each bank. What difference does it make, as long as the advertising well done yields a dividend of profitable business?

For your convenience, Mr. Don Knowlton, Publicity Manager of the Union Trust Company, Cleveland, Ohio, and Chairman of the Financial Advertisers Association Research Committee on Methods, has prepared a preliminary report, Specimen Advertising Appropriation, copies of which are ready for distribution. You will find in this explanation a simplified working chart which can be used as a guide in working out your next year's advertising budget.

Discussion

STEPHEN J. SPELLMAN (Lincoln Alliance Bank & Trust Company, Rochester, New York): What I have in mind is a little different from written copy but nevertheless it is advertising. For example, it has just been called to my attention that a representative of our new business department in Rochester will go out to interview a prospect (for example, suppose that this company happened to be in the oil business, and that the firm was just establishing a branch office) and to secure the business, the solicitor, without definitely committing himself, will hint that he can secure business for this company if they open an account with the bank and proceed to do business with it. It is my opinion that while it may work out in some cases, it is not a real part of a representative's duty to make such promises. It may work in one case and not in another. If

the business does not come to the customer in the volume he expected, it will create dissatisfaction; news travels fast and his friends will hear about it.

MR. REED: In the first place, it hasn't much to do with the advertising appropriation. Of course, I have my own ideas about everything pertaining to advertising and new business.

This incident took place not long ago in the city of Chicago, for instance. A charming lady who was a wonderful saleswoman offered to secure hotel rooms at a certain convention city if her railroad secured the business. She made certain promises on condition that she secure the business. They gave her the business. As it happened, they didn't take the hotel rooms, but if they had wanted them, they couldn't have got them, anyway.

It is a matter of policy whether you are going to allow the business managers to go out and make promises for the purpose of securing business. That is an internal policy that will have to be decided by the executive committee, I should think. Am I right? A great many are nodding their heads in assent.

THE CHAIRMAN: While this is off the subject of advertising, I think the more you get into the reciprocal business and solicitation of accounts, the more you will have this difficulty. This is particularly true with insurance companies. I think one of the greatest difficulties the secretary of our company used to have was to keep a check on the balances maintained by the insurance companies and try to allocate such business as he could to the best depositors.

We used to get letters from com-

panies selling everything from rubber stamps to furniture and fixtures, telling us they would open an account with us if we would give them some business. It is a certainty that the next time another bank is in need of the same product, they will write the same kind of letter to that bank.

Of course, if it is a matter where a million dollars' worth of steel is involved incident to the erection of a large building, that is another matter; that becomes another question in the actual solicitation. However, I think the solicitation of business on the reciprocal basis is dangerous. The answer we have always given is that we would be glad to have the account and if later on we could allocate any business, we would be glad to do so, but that we would have to do it on the same basis as with other depositors, with preference to those with whom we had been doing business a longer time. I think the average substantial business man will appreciate that as a good business attitude. It is the only way of putting it.

HAROLD D. COTHRELL (First & Tri-State National Bank & Trust Company, Fort Wayne): I purposely waited until Mr. Reed had read his paper so that I could ask him regarding newspaper advertising. This is a pet theory of mine. It seems that newspaper advertising, in most budgets, occupies first place. It is impossible for our bank to get the type of work, that is, typography and layout, that is used by Mr. Fuchs in St. Louis. We haven't a budget that will take care of that.

We have specific services to sell to a certain line of customers. Those people are not using all the requirements of our bank. We could run

a trust advertisement but we don't know how many trust prospects that will hit. It is uncertain. It seems to me the more logical thing to do to make them profitable customers for the bank is to take a definite prospect list and send them our literature. The same holds true for the various other services of the bank.

I am inclined more and more to relegate news advertising to the third or fourth place on the budget, for the simple reason that it is necessary to have art work to put it over, and that is too expensive for a bank such as ours. With a larger bank that can spend more money, it is a fine thing.

I should like to hear from Mr. Reed or Mr. Fuchs regarding this.

MR. FUCHS: I should like to know how your bank ranks in your city compared with other banks.

MR. COTHRELL: It is by far the largest.

MR. FUCHS: You ought to set the pace in the matter of newspaper advertising. You ought to be the leader in financial advertising if you are the leader among the banks. You can spend less for space and more for art work and typography. It will pay you in the long run. I would rather use two advertisements with effective typography than ten set up cheaply by the newspaper itself. You will be saving money by running two or three advertisements well set up and well illustrated rather than running a greater number of insertions of an advertisement with art work and typography that are not as good.

You have to attract the attention of the public. You must get them to read it. If you have mediocre material, it is a waste of money, as I see it. I would recommend for a bank

that does not have very much money to spend that it spend less for space and more for typography and art work. There is the same difference that there is between an eighty-five-dollar and a twenty-seven-dollar suit of clothes.

MR. REED: I do not believe you have anything to worry about as long as you have started on an analysis. The whole thing is based on analysis. Analyze your problem and set down the way to do it; after you have that, you can sell your executives on it. I do not believe any one can tell any

individual bank just how to advertise unless he knows all the details regarding it.

A great many of the banks today have to stay in the newspapers because their absence would make them conspicuous. That is the only reason some of the bankers are staying in the newspapers to the extent they are. If you have definite prospects and know who they are and want to reach them with a definite message, of course, direct mail will do the work more effectively and at much lower cost.

Modern Art in Advertising *

By JOHN A. REYNOLDS

VICE PRESIDENT OF THE UNION GUARDIAN TRUST COMPANY, DETROIT,
MICHIGAN

Address before the Denver Departmental Conference

Mr. Reynolds poses the question, "How could we come to a thoroughly modern building, in a thoroughly modern automobile, to sit in thoroughly modern furniture, and turn out thoroughly ancient advertising?"

Modern art and advertising are inherently related, because they have grown up side by side.

Modern art does not, of course, mean modernistic art, with its many rays and geometric figures. Good modern art differs from mere pictorial story-telling, in that it is concerned with the effect it produces upon the emotions of the beholder. The modern artist is not trying to tell a story; he is working, instead, on form, line, color, tone. All of these have very definite, if somewhat subtle, effects upon our emotional selves.

The advertiser, of course, cannot hope to get satisfactory results in any art form unless he engages a thoroughly competent artist.

IT would be well, if possible, to define modern art. If art were understood, which I am inclined to doubt a little, modern art would be easily understood, because surely "modern" means to all of us contemporary, now, or up to date, but because of our hazy understanding of any art, ancient or modern, and because the word "modern" has come to mean something in addition to contemporary, our definition will not be so simple.

Let us assume, then, for the sake of clarity in this talk that modern art is just contemporary art, and perhaps discuss the other complicated meaning of the word "modern" later. That would seem to leave us still with the problem of clarifying our hazy understanding of art, the real old capital letter Art.

WHAT IS VISUAL ART?

The usual uncritical understanding of the term art, that is, visual or plastic art, is that it is just a picture of something. That seems to be at first thought a perfectly justifiable conclusion: have not all the great artists of all time made just pictures of something? It seems so. But is that all they have done? Isn't an ordinary photograph a picture of something? But is it art? I am afraid that the problem poses the question. Well, isn't a photograph in which the subject has been carefully chosen so that a story is told, art? I do not think that any of us would assert that it is.

You know the story-telling quality in a picture has often been confused with art. People have a way of liking a picture because they like the

* Because of Mr. Reynolds's inability to be present, his paper was read by the assistant chairman, R. S. Racey.

story, or the subject matter. Many a real work of art has told a story, but so has many a cheap newspaper illustration. Obviously, that characteristic is not one of the essential æsthetic qualities.

It would then appear that we must find some other characteristic in a work of art that makes it such. I think that the modern artist has done it for us, and perhaps it would be wise to drag him in right here. The modern artist, by studying the ancients, has rediscovered a vital and important fact: art is an emotional thing. Forms, lines, colors, tones, in their relation to one another, have very definite, if somewhat subtle, effects upon our emotional selves. You realize, of course, that many a work of art does not involve a picture at all: beautiful rugs, pottery, furniture, and architecture, all affect us emotionally. A painting differs from these things only in the sense that because of its unlimited expressive possibilities, it becomes more than a design. Depth, created by the illusion of the third dimension, the illusion of solid forms, voids, mysteries, all harmonizing or counteracting to make an organization, are some of these possibilities.

THE EMOTIONAL APPEAL OF MODERN ART

Let us discuss emotions a bit, because that is what I am going to stress in this talk. Most of us imagine that we are not very emotional—especially hard-boiled bankers. They say emotions are for actors, artists, and other crazy people. Probably we do not know ourselves. What person, even a banker, does not remember with pleasure the effect a

certain smell or color had upon him in his youth? Every time I smell cedar now, I can well remember the joy with which I built houses out of cedar paving blocks. An emotional experience, surely, and one of the subtle ones too, as distinguished from the hair-tearing and tragic emotions aroused by intense sorrow or grief. I think that it is customary to measure emotion more by its bulk than by its quality. Some emotions are hard to recognize. An æsthetic emotion is often so subtle that it is missed entirely. Perhaps I may claim that you had an æsthetic emotion when you preferred a blue necktie to a yellow one. A person involved in any occupation which necessitates the use of taste has an æsthetic emotion every time he deems it necessary to change or move an object to please himself. A housewife has one when she finds it necessary to rearrange the flowers in a vase. An æsthetic emotion is a rather recent discovery. People have always had them, but didn't know it. They are based in our deepest consciousness. Every line, form, tone, color, has some emotional significance. I hope that I have proved by all these simple and clear facts, that art is an emotional experience and not a mental or purely visual one. Modern art is significant only as it proves that fact.

APPLICATION OF MODERN ART TO ADVERTISING

Now for its application to advertising. The modern commercial artist has learned from his contemporary modern fine artist, the fact of the emotional appeal. True enough, commercial art, when it was first used, was just a picture of some-

thing. But advertisers, bright people that they are, have also learned that subtle emotional qualities are necessary. Any commodity's character can be suggested by the character of its advertising. If the object to be advertised is a woman's article, delicacy and femininity are suggested in the advertisement. A delicate letter in the heading, color of a delicate or feminine shade, is used. All the appeal emotionally is made to feminine taste. Hosiery has been sold by The MacCallume Hosiery Company with a drawing of a woman whose hosiery was completely hidden.

The color red has been used in advertising very freely because of its direct emotional appeal, and we are not selling to bulls.

The improved appearance of most modern advertisements, caused by their careful layout and arrangement, has involved the exercising of the same faculties by the artist as Da Vinci's "Mona Lisa" or Rembrandt's "Woman Paring Her Nails"—perhaps a little less complicated, but the same, nevertheless. Remember, the public has not the taste of an æsthete.

THE EFFECT OF LINE

Any one who has studied art, commercial or otherwise, soon learns, just as Cézanne, the father of so-called modern art, learned that a line drawn parallel to any of the edges of a canvas is static or placid, and a line crossing diagonally is dynamic or active. This is one of the very necessary bits of knowledge in commercial art. Just as red is in a primitive sense such a violently emotionally moving color, so has every color and every color relation an ef-

fect on our emotions. Color at times leads to our first noticing an advertisement, then to our reading it, and finally to our buying the object advertised.

Modern art is a rediscovery of the emotional effect of line, form, color, tone, and an understanding of psychological suggestion, made possible by their relations. This is modern art's contribution to the great and necessary business of advertising.

I think that advertising has taken to modern art because it has grown up with modern art. Advertising is an entirely modern institution. How could we come to a thoroughly modern building, in a thoroughly modern automobile, to sit in thoroughly modern furniture, and turn out thoroughly ancient advertising?

While I believe that what I have said deals fairly completely with fundamental facts about modern art, various questions may still exist in your minds.

CHARACTERISTICS OF MODERN ART

How does modern commercial art compare with traditional, conventional art as a practical tool of advertising? Perhaps the best answer may be given by stating certain characteristics of modern art as compared with its highly conventionalized forerunner.

1. Modern commercial art is concerned only with significant forms and relationships. It casts aside the superficial, inconsequential details, and achieves thereby a simplicity and directness admirably suited to an age of hurry in which he must run who reads.

2. Modern art attracts by æsthetic appeal, whereas pure realism is

dependent upon what interest, if any, the reader may already have in the product or service depicted.

3. Modern art creates the implication by association that the advertiser is modern, up to the minute, and therefore probably provides a product or service that is up to the minute also.

An interesting thing about modern art is the fact that those most against it at one time are repeatedly finding themselves preferring it a short time later. The growth of its use in advertising has been by leaps and bounds. Today its use is decidedly in the lead over the old-style art among leading advertisers. My prediction is that it will eventually practically eliminate its decrepit forerunner.

Of course, there is considerable confusion in understanding, if the word "modern," as we have said, has come to mean many things besides contemporary. Many people confuse the modern with the "modernistic." A drawing, to have the

qualities which I have stressed, does not have to be full of rays and geometric patterns. By way of explanation, let us illustrate. The Ford Motor Company advertising uses illustrations that are modern. So do Cheney Silks, Heinz Products, Westinghouse, and hundreds of others. Camel Cigarettes are advertised with modern art in publications going to the more intelligent people, with old-type art in media going to the other classes.

If you are wondering whether you should use modern art in your advertising, there is one thing important to remember. There is good and bad modern art, just as there is good and bad traditional art. Do not expect to get the right results merely by deciding, "I will use modern art," and then calling in Tom, Dick, or Harry and asking him to make you a picture in the manner of Rockwell Kent, De Monvel, Erickson, or Williamson. Even modern business has found no way to get figs from this-tles.

The Problem of Layout in the Modern Newspaper

By J. K. WAIBEL

ADVERTISING COUNSEL OF THE CONTINENTAL ILLINOIS BANK AND TRUST COMPANY, CHICAGO, ILLINOIS

Address before the Denver Departmental Conference

Mr. Waibel feels that it is the layout of the advertisement which determines the mental picture of a bank which is to remain with the reader.

It is for this reason that he believes that while the bank advertisement must be individual and modern, it must at the same time be reasonably conservative if it is to leave an impression of the bank's stability with the reader. Accordingly, the form of the advertisement should not be changed too often or too drastically; if the form does need changing for good and sufficient reasons, then the changes should be made gradually over a period of time.

The four factors to work with in preparing an advertisement are the unit (size and shape of the advertisement); the type; the illustration; and white space. These mechanical ingredients, considered in connection with the advertising appropriation, determine the advertising layout which will be used.

THE subject that has been assigned to me is most profitably discussed with occasional reference to other phases of advertising, such as copy and copy unit, and also that most sacred of advertising belongings, the advertising appropriation. The reason is that these are units of the whole, and to treat any of them as apart and distinct from all else that enters into bank advertising is likely to lead to misunderstanding.

Bank advertising is neither the legitimate nor the illegitimate offspring of mercantile advertising. It was not begun in imitation of mercantile advertising, and its history shows no foreign ancestry. In some quarters bank advertising has been made to partake of the nature of mercantile advertising, and it is in this

circumstance that the problem of layout for bank advertisements looms large.

DIFFERENCE BETWEEN MERCANTILE AND BANK ADVERTISING

I do not know of any distinction that has been drawn between mercantile advertising and bank advertising, but for the purpose of this talk I am going to point out one.

Manufacturers sell tangibles: radios, automobiles, clothing, and so on. Banks sell intangibles: security for deposits of money and valuables, bonds, and a multitude of financial services. The advertising of the former seeks the sale of commodities, through whose wearing qualities, attractiveness, and usefulness the maker obtains reputation and good will.

The advertising of a bank cannot seek the sale of a commodity. It can only make a favorable impression and convey the idea that the bank is a desirable place to leave our money and obtain a high order of financial service.

Therefore, in the commercial field advertising does primarily a selling job, and secondarily a job of representing the advertiser. In the banking field, this order is reversed. The first task of a bank's advertisements is to represent the bank; the second task, to sell the bank's facilities and services.

If we grant that a radio advertisement represents the manufacturer and add to this the fact that every radio receiver sold by the manufacturer's advertising adds to his reputation and popularity, we gain a fair idea of the burden put on the shoulders of bank advertising.

Its advertisements, then, are the sole inarticulate representatives of a bank. But an automobile is the throbbing, utilitarian representative of the manufacturer long after the advertisement that influenced its purchase has been forgotten.

This single fact, perhaps more than any other, creates a layout problem for the bank advertiser.

IMPORTANCE OF ADVERTISING COMPETITION

When we think of advertising in newspapers, we are inclined to place too much emphasis on the competition for reader attention that our advertisements will have. When this fear of competition strikes us, we begin to feel that our efforts are all but lost, unless we buy large space units and give our advertisements such lay-

out and design as have never before been seen.

Let us regard for a moment a metropolitan newspaper. It is forty pages strong, and analysis shows that 48% of it is given over to display advertising, 8% to news pictures, and 44% to news and editorial matter, including comic strips and classified advertising. The fact that this is a Monday edition accounts for its slowness.

Now let us turn to a Friday edition of the same paper. It is sixty-eight pages long and its display advertising-content runs 62%, news pictures 8%, and all other matter 30%.

This gives you an idea of the forest in which a newspaper advertiser plants his tree and hopes that people will find it.

As you turn the pages of your newspaper with an eye to advertising your bank, and as you attempt to gain an idea of the kind of layout your advertisement should have and the amount of space it should take, you ask yourself, unconsciously, this question: What are my competitors doing? When you have determined that, you have not solved your problem. Even if you analyze all of the newspapers in your city over a period of time, and record the number and size of the advertisements your competitors place in a given time, you have not reached your starting point. Your research is likely to be disheartening, because forthwith appropriation is involved; and more often than not, the other fellow seems to have more money to spend on advertising than you have.

What with the advertising competition that is disclosed whenever you open a newspaper and the usually limited advertising appropriation a

bank has, is it any wonder that a bank advertising schedule is slow in going into effect?

Yet banks should advertise. I firmly believe that banks which do not advertise not only fail to contribute to general economic growth, but also fail to do the utmost to reward their stockholders.

Bank advertising is not the easiest thing in the world, and newspaper analysis to determine what you face in the way of bank advertising competition does not solve your newspaper advertising problem as to copy, copy unit, layout, appropriation, or anything else.

We must, therefore, find a different approach to our problem, and that approach should be as practical as we can make it. Many difficult problems are solved by introspection, and bank advertising is no exception.

EACH ADVERTISEMENT MUST EXPRESS THE INDIVIDUAL PERSONALITY OF THE BANK

Banks are service organizations with nothing tangible to sell. This leaves banks to advertise themselves chiefly through the device known as institutional copy, and it is in the bank's seemingly unfortunate advertising position that we find the key to the problem of bank advertising in all its aspects, including, of course, layout.

Time was when banks were regarded as merely banks, much as corporations were regarded as possessing no souls. A bank is a corporation as much as is an incorporated business concern; and the law, which recognizes corporations as natural persons, gives us the first hint that a bank may

have personality. I think you will agree with me that no two banks are exactly alike. They differ in location, in architectural treatment of their buildings, inside and out, in atmosphere, personnel, furnishings, equipment, personality, courtesy, and so on.

A bank, therefore, is an entity, with an individuality given it by its outward appearance, its inner workings, and its personnel.

It is within the bank itself, therefore, that we find the beginning, the operation, and the justification of bank advertising. And as bank advertising is or should be a by-product of a bank rather than something devised especially to occupy newspaper space, the layout of a bank's advertisements should be in consonance with the bank's individuality as much as the advertising copy and everything else that enters into its advertising. The layout need not be inflexible to embody a bank's individuality, but it should never fail to harmonize with type and copy in creditably reflecting and projecting the bank wherever the newspaper in which the bank's advertising appears happens to be read. If we keep these points in mind, there is no danger of our producing advertising of the so-called "distinctive" variety which is foreign to the institution it is intended to typify.

MECHANICAL ASPECTS OF NEWSPAPER ADVERTISING

Let us turn now to the mechanical aspects of newspaper advertising in considering our problem.

A newspaper may be likened to a city; the advertisements in it to the buildings in the city. As we wander through the city we are attracted

here, repulsed there, by architecture, color, shape, size.

If your advertisement does not have commanding size, it can have at least pleasing proportion and color tone. Much can be said in favor of size—our newspapers are not getting smaller—but a large advertisement of poor design is a far weaker advertisement than a small one of good design. However, rather than size, let me stress shape. I have seen very few full page advertisements in newspapers that were really good-looking. The reason is that a newspaper page is too wide in relation to its depth. And in this connection layout is concerned with form and areas.

The ancient Greeks had their golden rectangle to beautify their art, and it has not been displaced as a unit of pleasing proportions. If we use this as a basis for a unit adaptable to newspaper requirements, we have 7 inches on 2 columns; $10\frac{3}{4}$ inches on 3 columns; $14\frac{1}{4}$ on 4 columns, and so on. But if we follow these proportions our unit will run off the newspaper page at the top before it has spread across the 8-column width.

We cannot leave form without giving thought to its principal item of dress, type. The type faces on the market today provide virtually every advertiser with a plastic medium to dress his message.

TYPE

The National Board of Printing Type Faces has just given its approval to a wide variety of type faces. The advertiser should have no difficulty in choosing from these a type face expressive of his product, service, or organization. These faces are:

the Caslon family; the Bodoni family; the Cloister family; the Garat family; the Goudy family; Kennerly old style; Nicholas-Cochin; Les Cochin; Futura; Cooper; Kabel; Scotch Roman; Bookman; Goudy modern; Century expanded; Forum; Baskerville. This is a formidable array, and I venture to say that if seven of these types were lacking from the list, no bank advertising man could bemoan a lack of type media.

ILLUSTRATION

In addition to type we have illustration to conjure with. Frankly, I prefer to conjure without it in bank advertising, because I have never seen a satisfactory picturization of credit. Allegorical pictures, it seems to me, have run their course in bank advertising, and it is time to be realistic. But do not show a picture of your bank building or your bank interior in every advertisement you publish. Altogether too many attempts are made by banks to give their advertising individuality by using pictures of their buildings.

So far as I have seen, pictures used in bank advertisements seldom serve to elucidate the message. They merely make the advertisements bigger and serve to attract attention by sheer size.

WHITE SPACE

One other factor enters into the design of an advertisement, and that is white space. We start with white space in making an advertisement, and we should finish with it. White space does as much for the appearance of an advertisement as it does for the delivery of the message.

Thus we have four factors to work with in preparing an advertisement: the unit (size and shape of the advertisement); the type; the illustration; and white space.

These are the mechanical ingredients, and every advertisement must have at least three of them in proper amount and of suitable kind.

I wish that I could give each of you specifically my notion in rough layout as to how your bank's advertisements should look, but I cannot do that. I know nothing about your bank, its policies, its earnings, its personnel. All such facts enter into a bank's advertising program from appropriation down to copy, and up again through layout to the finished advertisements.

THE INVENTORY METHOD

The only real method that I have been able to find to give a bank advertising that is typical of the institution and its policies is the inventory method. An inventory of advertising assets, which includes all the publishable facts about your bank, taken by a competent person, is the foundation on which your advertising program should rest. From it will come not merely the ideas that inspire your bank's advertising, but the very substance of your copy, the means to determine the size of your copy unit, and the spirit and scope of your bank, seeking expression in type and form in layout.

ADVERTISING APPROPRIATION

So much of what you do and how well you can do it in advertising depends on the amount of your appropriation, that it is not amiss to

point out that the amount of a bank's advertising appropriation should be determined on two grounds:

1. The amount the bank would like to spend, in the light of its advertising inventory
2. The percentage of earnings the bank feels it can spend for advertising.

By averaging the two amounts you come close to what you should spend for your advertising. And once you know the amount of your appropriation, its allocation to the various media is not difficult.

When you know how much money you have to spend in the newspapers, you are ready to solve your first layout problem, the size and shape of your copy units.

BORDER

The next thought might be given to border. Shall your advertisements carry an all-around border, top and bottom border strips, side border strips, or no border at all? Somewhere within the four walls of your bank lies the answer to this question. If the outside or inside architectural treatment of your bank suggests a border design, you may do well to use it, if it can be made to conform to the general symmetry of your advertisement.

White space in your newspaper advertisements is as important as type. Do not obliterate the white space in your advertisements from within; the printed matter around them tends to do it from without. You can ill afford to use up more than two-thirds of the space within your copy unit. Give your advertising messages breathing room even if your bank has stuffy quarters.

The choice of a type face is most difficult if you seek something representative of your bank. But this fact need not keep you from advertising. You solve the type problem by type arrangement. If your bank is conservative or long established, your choice of type naturally falls to the conservatively designed or time-tested types, such as Caslon, Cloister, Garamond, Kennerly, Bodoni, or Goudy. There is a pronounced discontinuance of modernism in typography, and banks will do well to guard against the use of type that may have short-lived appeal.

The name of the bank is one of the most important units in a bank advertisement. Together with the headline, it can and should convey the meaning of the advertisement. But the signature should be typographically in key with the advertisement as a whole. Avoid coarse hand lettering and tricky arrangement. Use type for your signature if custom has not wedded you to lettering.

AVOID SUDDEN OR UNNECESSARY CHANGES IN FORM

Once you have established a good form that is reasonably typical of your bank, use it. It cannot do a good job in representing your bank if its design is changed from time to time in response to "inspirations." If the form of your advertisements needs changing for good and sufficient reasons, then make the changes gradually over a period of time, rather than allow your advertisements to burst forth suddenly in new dress.

Build into your advertisements and their messages as much of your bank as you can. The American tempo, with its attendant growth in business

and banking, will keep your well of ideas from running dry.

If I can leave but one thought with you on the subject of layout, I shall feel amply rewarded for coming here:

Layout is the art of advertising-impressionism. Properly handled, it gives not only your advertising, but your bank as well, the atmosphere of individuality. It is important because it is the thing by which your bank is remembered long after all its advertising messages have been forgotten. It can give newspaper readers a mental picture of your bank that will make them so well disposed toward your bank that they will establish an insurance trust with you when the advertising of several other banks has convinced them of the desirability of an insurance trust.

Discussion

STEPHEN J. SPELLMAN (Lincoln Alliance Bank & Trust Company, Rochester): I should like to put Mr. Waibel to work. The Lincoln Alliance is a correspondent of the Continental Illinois. I wonder if you would mind writing up a sample form for bank advertising.

MR. WAIBEL: It is against our bank's policy. I should like to do it for you. I don't mind telling you we have 5,300 correspondents. Fully 10% of those correspondent banks have the bright idea that because we have an advertising department manned by six persons who are supposed to know something about advertising, and because we employ the services of two advertising agencies, we should be willing and happy to solve the advertising problems of those correspondents for them. The reason we cannot do it is because we

so firmly believe in individuality in advertising that we are afraid, if we undertook to help them, we would be turning out something that did not reflect their own institutions.

The idea of reflecting the individuality or personality of a bank in advertising is, as Mr. Reed, I think it was, said, one of the newer developments in advertising thought. We believe in it; we practice it; and advise our correspondent banks to do likewise.

Surely you have a lot of brains in your institution and you certainly know your institution better than we do, better than we could hope to know it.

MRS. KATHRYN BERKLEY (Fidelity National Bank & Trust Company, Kansas City, Missouri): I should like to ask your opinion as to how often you think a bank should advertise to be effective.

MR. WAIBEL: Much depends on the place the bank occupies in your city, whether it is first, second, or third, how much money you have to spend, and a great many

other things. I think the answer to your question would lie in the survey of your bank's advertising assets. If that survey were to show, for example, that in relation to other trust departments your trust department is weak and you want to go on record publicly that you have one and that it is as good as others, if not better, or if you wish to let the world know something about your trust department, its individuality and management, and so forth, you ought to do a rather frequent job of stressing that in the newspapers.

MRS. BERKLEY: That is what I had in mind, the frequency of getting the name before the public.

MR. WAIBEL: It is hard for me to answer the question. I should say that at least once a month you could afford to run a trust advertisement and perhaps once a month a commercial advertisement. If you can step it up to once a week, that would be fine, and you should try to appear the same day each week, every Monday or Tuesday, or whatever day works out best for you.

Credits

The Modern Credit Attitude

By CHARLES C. KIMBALL

ASSISTANT VICE PRESIDENT OF THE MERCHANTS NATIONAL BANK OF BOSTON,
BOSTON, MASSACHUSETTS

Address before the Denver Departmental Conference

" . . . It was with the advent of the scientific spirit into bank credit work that the evolution of the credit attitude began. Like the manufacturer and the merchant, the credit man began to insist on facts instead of fancies as a guide to his policies. Personal impressions were supplemented by balance sheets. Rules of thumb gave place to scientific analysis."

The immediate result of this change of attitude was to strengthen the bank's position by enabling it to predict, and so to avoid, losses. But this was at no time a policy of pure self-interest on the part of the bank. If its researches enabled it to locate the weak point in the credit policy of one of its customers, dangerous to its own safety, it was serving him too, in pointing out a situation that needed correction. Moreover, helping a man to help himself is a procedure which attracts other men, and new business is likely to be the result.

In the stream of industry there would seem to be two currents, moving with equal rapidity in opposite directions: on the one hand, the obsolescence and eventual disappearance of the old process; on the other, the emergence of the new. To both currents the credit man must give his attention, withdrawing support here; extending it there.

To meet all the requirements which these manifold duties demand of him, the credit officer today must be well trained in the principles of analysis, in modern business trends, and in the interpretation of trade conditions. He must, moreover, be a man of heart, imagination, integrity, and courage.

THE title announced for my subject implies a contrast, the setting off of something new against something old. As with many contrasts of this kind, though the difference may be as wide as between man and amoeba, the new is the outcome of the old through the gradual process of evolution. Not so many years ago the protection of its bank from loss was considered almost the full duty of a credit department. Perhaps it was admitted that one hundred per cent protection could not be achieved without cramping the growth

of the bank by eliminating many reasonable business risks from among its potential customers. Yet the eyes of the credit department were turned inward in introspective consideration of the notes in the discount portfolio. So far as possible, the profits of the bank must not be reduced by uncollectable paper.

We have been told again and again, until the discovery has lost its newness, that the most striking characteristic of our business life in the past few years has been, not the tremendous increase in size of individual

units, the speeding up of production, or the expansion of markets, but the development of the scientific spirit, of which all these are the inevitable result. I mention it at this time not to weary you by pointing out a truism, but because it was with the advent of the scientific spirit into bank credit work that the evolution of the credit attitude began. Like the manufacturer and the merchant, the credit man began to insist on facts instead of fancies as a guide to his policies. Personal impressions were supplemented by balance sheets. Rules of thumb gave place to scientific analysis.

EVIDENCES OF THE SCIENTIFIC SPIRIT IN BANK CREDITS

At first improved credit methods served as instruments to strengthen the safety factor. If improved technique made possible surer and earlier diagnosis of business ailments, there was just so much more chance for the bank to get out of a loan without loss. Gradually, however, it began to dawn on the more forward-looking credit men that if new methods gave quicker warning of trouble, this warning brought with it an opportunity to correct the trouble while there was still time. If the receivables of the Richard Roe Manufacturing Company were slow, there was something wrong with its credit policy. Obviously, if it sold on shorter terms or pushed collections more aggressively it would set free capital and would have to borrow less money. If this fact could be impressed on Mr. Roe, it might be possible not only to save the loan but to save the customer. With the attainment of this viewpoint we have the beginning of the modern credit attitude.

Now, if, through the researches of

its credit department, the bank can find ways of strengthening its customers and promoting their growth, this will in the long run mean increased business. Bigger and better customers will mean a bigger and better community and a bigger and better bank. Frequently we see some such appeal in bank advertising as "Become a depositor and grow with the Fiftieth Bank and Trust Company," but the modern credit attitude places the emphasis on having the Fiftieth Bank and Trust Company grow with its customers. It aims to have the credit department become a department of business development.

This policy of enlightened self-interest, of helping yourself by helping the other fellow, is becoming increasingly common in credit work. It is by no means confined to banks; in fact, some of its most striking exemplifications are found in the mercantile field. Manufacturers and jobbers who see their customers disappearing before chain store competition have undertaken to instruct the retail merchant in efficient methods of merchandising. If the credit department of the Van Camp Hardware and Iron Company of Indianapolis has reason to think that one of its retailers is on the down grade, its traveling representative calls and insists that as a condition of further sales the customer install the standard accounting system which the company has devised. The representative helps the retailer install the system, which provides for frequent reports to the credit department in order that it may follow the customer's progress closely and offer such advice as may be necessary. Similarly, the Brown Shoe Company of St. Louis has developed a plan of inventory control which it sets up for

its retailers, and they in return agree to handle Brown products exclusively.

While such constructive service begins with men and companies that are already customers, its repercussions extend beyond the immediate circle of depositors. If you help a man to expand his business and make more money, you not only bind him to you by hoops of steel, but he wants to tell his friends about you. Business building advice has definite advertising value, which is bound to react to the benefit of the bank.

DISCOVERING THE WEAK SPOT IN YOUR CUSTOMER'S ARMOR

As I suggested earlier, the opportunity for helping a customer is likely to open with the discovery that something is wrong with his business. This discovery is made through modern scientific methods of analysis. The methods commonly in use among bank credit departments today are those which have reached their highest development in the work of Alexander Wall, Secretary of the Robert Morris Associates. He has substituted qualitative tests for the quantitative comparisons which were previously employed. Mr. Wall is here this afternoon and is to give you a practical demonstration of how scientific analysis is used in the detection and correction of business troubles.

I wish, however, to call your attention at this point to the test which today is the keynote not only of commercial success, but of credit soundness—the test of net profits. The business which is not earning a satisfactory profit is not justifying its existence. The failure to show such a profit is a pretty sure sign that there is something wrong in the manage-

ment; a steady decline in earnings is one of the best indications of impending trouble.

The ability to make profits is not so much a financial problem as it is a problem of management, and to help his customer in solving such problems, the credit man must have a knowledge of the fundamental principles of business management. This does not mean that he must be an expert in the technical processes of manufacture and distribution in each industry, but that he must be familiar with the methods characteristic of successful modern business. From his own experience or from his studies of profitable companies he should be able to draw examples which will stimulate and guide the management of his unprofitable customer.

There has always been romance in the development, the evolution, of our industrial civilization. At no time has the romance been so transcendent as in the last two decades, when the forces of the scientific spirit became operative. Probably the spirit finds its focal point in the research departments of our great corporations. In quiet laboratories, expert scientists and engineers experiment, test, invent, till a product which revolutionizes our life appears on the market fully developed and commercially practical. The International Harvester Company after years of experiment announces a machine for picking and stripping cotton; the General Electric Company introduces a new refrigerator, mechanically complete; the American Telephone and Telegraph Company installs automatic switchboards which function from the start.

No less romantic than the discovery of new inventions through research is the discovery of new methods. Unit

costs are brought down through large scale production—an old story in the textile industry, but popularized by Henry Ford. Selling policies are based on scientific studies of markets, which gauge with uncanny accuracy the potential demand for an article and the price at which the demand can be satisfied. More remarkable yet is the coordination of production, distribution, and finance through budgetary control, by means of which all the forces of a business are directed toward a common goal, that of getting the product to the consumer as directly, as speedily, and as economically as possible.

This is the background from which the modern credit man approaches the problems of his customers. From it he draws the experience and the concrete examples with which to advise them. When he decides that the John Brown Manufacturing Company is carrying too much inventory, it is not enough to say to John Brown, "Your merchandise account is too large; cut it down." Such advice may effect a temporary correction by sacrifice selling, but it will not work a permanent cure. The credit man not only should point out the trouble, but should suggest the remedy in some form of inventory control, citing as an example the experience of successful companies.

INDUSTRIAL CONDITIONS LEADING TO TROUBLE

Hitherto, we have been considering business troubles for which management was to blame. Frequently, however, a company will find it difficult to operate satisfactorily, through no fault of its own but because of industrial conditions. There may be a de-

pression throughout the business world or a depression in the particular industry served by that company. For instance, in 1928, which we look back on as a good business year, the automobile tire industry was unprofitable because of the sharp decline in the price of crude rubber following abandonment of control of production by the British Government. Sometimes the depression within an industry may be of several years' duration because of overdevelopment of productive capacity following some unusual stimulus. The textile industries since the war afford an example of this sort. Under such conditions many strong and well managed companies are unable to show a profit because of circumstances entirely outside their individual control.

In such a situation the credit man can be of help to his customers only in so far as through his study of business conditions he is aware of the gathering storm and can give warning to shorten sail. His customers cannot escape the tempest but can only prepare to meet it. Once the hurricane has struck, they must ride it out as best they can.

Such storms, however, are temporary and eventually will pass, leaving the staunch and well manned vessels gale-battered, but afloat. There is another set of conditions, the effect of which is like a tidal wave from which there is no recovery. As our civilization develops, commodities which were once essential to our existence are supplanted or given up entirely as a result of new inventions or of changing popular tastes. Years ago, every inlet on the New England seacoast had its shipyard, where were built wooden sailing vessels. Then came the introduction of steam and

the use of steel, and the wooden ship industry all but disappeared.

Near where I live, there used to be a large and successful mill designed for the single purpose of producing cheap gingham, which were sold to the immigrant population in the foreign quarters of our cities. For years new immigrants poured in to take the places of those who had passed out of the gingham class. Suddenly immigration was restricted and the incoming flood of new arrivals ceased. The standard of living of the old immigrants became steadily higher, and the market for cheap gingham dried up. The mill could not sell its cloth at any price; why, they say that the operatives would not even steal it. The management held on obstinately, hoping that the demand would reappear. It has not yet; it probably never will; and if it did, it would come too late for that particular mill.

THE VANISHING INDUSTRY

This problem, the problem of the vanishing industry, was never more real. With research departments working overtime, with astounding new discoveries appearing almost weekly, there is ever present the possibility of revolutionary changes in our wants and in the way in which they are to be filled. In the comparatively recent past the manufacture of pianos was a large and relatively stable industry. The rapid development of the radio has driven the piano makers and the makers of piano supplies to the verge of bankruptcy. With these constant changes taking place in the business world about him, it is not enough for the credit man to diagnose his customer's health solely on his individual symptoms. He must keep

his finger on the pulse of the whole business world; must be informed regarding new discoveries and changing popular tastes; and must study their effects on our industrial life. Often a timely suggestion will enable a shift from a disappearing product to one coming into favor. At the worst, if the business cannot be saved, it can be liquidated while there is still salvage value.

If the modern credit man is on the alert to detect the obsolescent or dying industry, he should be even more watchful for the industry which is springing up to replace it or to supply an entirely new set of human wants. Among our largest corporations today are those making articles nearly or entirely unknown twenty years ago. The early months of this year have given convincing evidence of the dependence of our business prosperity on that youthful giant, the automotive industry. The manufacture and production of motion pictures has grown like a mushroom, with its most recent achievement, the talkies, a development of the last two or three years. Chain stores have revolutionized retail distribution and have spread across the nation. If the credit man can see the potentialities in a new industry; if he can judge the qualifications of the management of a particular company to realize those possibilities; and if he can help in their early development with wise counsel as well as with the courageous extension of credit, he will be making the greatest possible contribution to the prosperity of his community and the growth of his bank.

My bank numbers among its customers at the present time a manufacturer of a certain household appliance which has come into popular

favor within recent years. The company is one of the pioneers in its field, and its product is of undoubted merit. Financially, it has committed most of the sins in the credit man's category, using its bank loans as permanent capital, and incurring new obligations through the expansion of fixed assets, instead of building up its working position out of earnings. Because of our faith in the future of the business, however, we have been willing to excuse some of these financial eccentricities and continue our support. We may find that we have guessed wrong, but I mention it as a concrete example of present-day credit policy.

THE CREDIT MAN AND THE INVESTMENT ANALYST

It might not be out of place here to point out how closely this viewpoint of the credit man parallels that of the analyst of investments. Increasingly both are directing their energies to discovering and weighing the possibilities of the future. While they still analyze balance sheets and earnings statements of former years, they are interested in these records of past performance not so much as evidence of financial soundness, but rather as indications of the ability of the management to take advantage of new opportunities. A company may be sound now; it may even continue to be sound; but if it does not grow, the investment of its stockholders will not increase. Similarly, if it does not grow, its account never becomes more valuable to its bank. One large bank which has been among the trail blazers in developing wiser methods of granting credit will not even buy the six months' open market note of a company which, to quote from its let-

ters, "is not getting anywhere." Apparently it believes that its funds should be invested only where they will contribute to building up the business of the nation. If the business of the nation goes ahead, the growth of such a bank will take care of itself.

The wider vision of the opportunities of credit work has brought increased responsibilities to the credit man. The training and education which would suffice for a policeman of loans is no longer sufficient for a physician and architect of business. In addition to the knowledge of his predecessors, the modern credit man must have training in the principles of scientific analysis. He must be familiar with the methods, developments, and discoveries of modern business. He must have skill in interpreting trade conditions. The requirements for the work are many. They demand education and sound preliminary training, supplemented by continuous study. Greater than ever before, moreover, are the demands which the work makes on the character of the credit man. He needs a fund of human sympathy to enable him to appreciate the problems and win the confidence of his customers. He needs imagination to help him in his analysis of business and in his forecasts of the future; and he needs integrity and courage that he may face facts squarely, make decisions bravely, and protect fairly the welfare of his bank and his bank's customers. Education and character are the foundation of the modern credit attitude.

Discussion

FRED W. COWLIN (Second First National Bank, Los Angeles): Mr.

Kimball, I should like to ask this question: Is it always easy to convince a customer of the accuracy of conclusions reached by scientific methods of analyzing his statement?

MR. KIMBALL: Being a Yankee, I should like to ask you another question. Is it always easy to convince a customer of anything? However, there is this to be said: with scientific analysis we get a groundwork on which we can talk to our customer, and we don't have to say, "I think such and such a thing is so."

We say, "Look here; we have analyzed your statement. You are carrying six months' inventory; you ought to carry only two months'. The comparison of your sales and inventory shows it. Furthermore, Mr. Wall, through the Robert Morris Associates, has made a scientific study of your particular industry, and he shows that the average turnover is every two months and not every six months."

So, we have, through our methods of scientific analysis, the talking points and the facts with which we can go to our customer, and I think it is a much easier proposition to convince him than when we had to depend on our own opinion.

THEODORE F. HENKEL (Union Trust Company, Cleveland): How far can a comparison of balance sheets be trusted as a guide to the profits which a company is making?

MR. KIMBALL: It can't be trusted at all. If you have balance sheets running over a period of years and you set them up in your comparison form and look along the line of surplus account and see that it goes up \$100,000 each year, it is very easy to say, "Isn't this fine! This company is making money."

But when you, in your credit work, realize all the things a company can do to its balance sheet to increase its surplus, you realize that the surplus account isn't any indication at all of whether that company is making money or not.

I had an interesting case in my own work not long ago. We had a customer who, every time he made a loss, increased his good will account. I have always been told good will was an intangible asset, but I never saw a more intangible asset in my life than this capitalization of losses.

You have all kinds of increases in surplus accounts not due to earnings. You may have a refund of taxes for prior years. You may have a life insurance policy which, on the death of one of the officers, is paid into the business. Perhaps the management will mark up its fixed assets and show a large increase in its surplus, which may absolutely obscure an operating loss or a succession of operating losses.

The moral is that you can't trust the balance sheet alone: you have to have the profit and loss statement to show what is really happening.

ORVILLE L. RIEDER (The Cleveland Trust Company, Cleveland): In your closing remarks you spoke of study. I should like to ask what courses of study, in your opinion, are particularly helpful as preparation for credit work?

MR. KIMBALL: It is a pretty broad field. It is hard to single out particular courses, but I know that in our own work—and I think it applies to credit work in general—we like to have the men who come into the credit department have a knowledge of accounting. That doesn't mean that they have to be account-

ants, but they have to know the underlying principles of accounting, and it is a big help when they come to take up the scientific analysis of financial statements. I am very glad to see that the Institute in its program is going to include considerable material on accounting in its Analyzing Financial Statements course as a requirement for its certificate.

Also, gentlemen, there is this question of business conditions. A very valuable background for any study of business conditions comes in a knowledge of the theory of economics. We have an Economics course in the Institute. Economics is a mighty difficult subject. We all feel when we are studying it that we are studying something that is up in the clouds, and it is very hard to bring in the practical application to the work in hand. What we really need is applied economics, and that is a problem for the instructor who handles it; but to draw any intelligent conclusions from a study of business conditions a man ought to have a background of economic theory.

CHALMERS E. LONES (Security First National Bank of Los Angeles, Los Angeles): Isn't it true that now and then corporations of high standing declare dividends in excess of their profits, with the approval of loaning banks?

MR. KIMBALL: That is true. We see it all the time. I don't think, however, that that really affects the conclusions I have tried to draw. The wisdom of a declaration of dividends in excess of profits really depends on the past earning record of the business. If the conditions leading to a decline in profits may reasonably be considered temporary, I think it is all right for the company to pay

out the dividends. That is what it has accumulated a surplus for; but what we, as credit men, object to seeing, is a continuation of poor years, with no prospect of future improvement, and the company steadily eating into its surplus and working capital by the payment of dividends. That situation is merely wasting money. I think we all hope that the present dullness is going to be a temporary condition. Companies that have accumulated a large surplus in the last four or five years are in a condition to meet this.

THE CHAIRMAN: What you object to is the bank's paying the dividends?

MR. KIMBALL: Yes, that's it.

JOHN A. EISEMAN (Pennsylvania Company, Philadelphia): In considering an extension of credit, just how far do you allow conditions in any particular industry to sway your decision, especially if the company under consideration happens to be generally in good shape? In other words, suppose that individual company happens to show profits, perhaps not large, but continuous, yet you feel that the industry as a whole is going to go through a bad time or is in one: how much would you allow that outside situation to sway your opinion?

MR. KIMBALL: You will notice that in my remarks I frequently have to refer to the instruction and education which I have received from Mr. Wall, and if you are familiar with Mr. Wall's work you have probably seen the nice little charts he prepares, showing the different factors which enter into the analysis of a credit risk. He draws a pretty little diagram that shows perhaps 40% of the risk represented by the financial

aspect, 40% represented by the management aspect, and 20% represented by the condition aspect.

You can't make any fixed rule. You have to take all three aspects into consideration when you are granting credit. If you have a company that is otherwise sound, you must not be unduly disturbed by the fact that you are going to have a temporary depression. But in the case of what you might call the marginal borrower, such as we all have, one of the factors may not be satisfactory, and you may be willing to take a chance on him in good times, whereas you wouldn't in bad times.

HOWARD T. HARDIE (Union National Bank, Pittsburgh): Does the fact that a company is using scientific methods of coordinating the activities of its various departments entitle it to a larger line of credit than it would get otherwise?

MR. KIMBALL: It entitles it, Mr. Hardie, to a larger line of credit, and the bank has a more comfortable feeling in extending such credit if it knows that the company is using such methods; but if it has proper coordination of its various departments, it is going to need less credit than if it didn't have that coordination.

DARIUS M. NICKERSON (Washington Park Branch, Industrial Trust Company, Providence): If one of your customers, using the limit of his line of credit, started showing a loss in his profit and loss statement, under what circumstances and to what extent would you extend further credit, if any?

MR. KIMBALL: That is a hard question. You have stated that he was starting to lose money. The first thing you would want to know was why he was starting to lose

money and what the chances were for correcting that situation, so as to turn red ink into black. You would have to satisfy yourself of those conditions before you would be willing to decide on further extension of credit.

I don't know whether that answers your question or not, but the question as stated really gives only a part of the problem.

MR. NICKERSON: You would recommend a complete analysis of his business?

MR. KIMBALL: Exactly. If you couldn't make it, you would probably refer him to some firm of industrial engineers which specialized in businesses of that type.

THE CHAIRMAN: There are very few companies that have not lost money in the first quarter, and the probabilities are that they will continue their losses in the second quarter. The banker has no right to become nervous and immediately withdraw his line of credit or become uneasy about that customer, as long as no new elements which endanger the business enter into the situation. A favorite question today, as the customer comes in to renew his note or to pay part, is, "Well, how much money did you lose this quarter?"

None are offended. In fact, it is the opening for them to sit down and talk with you and receive a little sympathy. As a matter of fact, the banker must talk to his customer today more than at any time in the last five years. The facts he receives from one customer are of value to another, and when I go back home there is no doubt at all that I shall look at more balance sheets on July 1 for those who close their fiscal year on December 31 than at any time since 1920.

MR. HENKEL: In my work I come in contact with many manufacturers. I have heard this from several: they claim that the banks can help them more than they are doing; they feel that there is a little too much coldness, and that, if the banks would open up a little more and assist them, it would be helpful. That was brought to my attention just last month. Is there anything to that?

THE CHAIRMAN: Oh, yes, the customer quite frequently, not only in these times but at all times, complains about the coldness of the banker. That usually means that the banker wouldn't warm up and give him more money than he should have. That is the alibi customer.

In the Saturday Evening Post of October 5, 1929, an editorial spoke of that situation and expressed the hope that bankers might get more reputation for coldness rather than bring about failures. In many instances I feel that it is complimentary when customers speak of me as cold. I certainly could not warm up to many of their propositions.

ALEXANDER WALL (Robert Morris Associates, Lansdowne, Pennsylvania): May I interject at this time something you will recall in line with what you have just said? At one of the meetings of the Robert Morris Associates about a year and a half ago, we had as a speaker a man who had a very large business of his own, and had been the president of a trade association of business executives in that line of business. He opened his address to us with a plea that the bankers start a resolute refusal of credit, because credit had been made soft in that industry, and this had brought about more grief

than any other thing that had happened.

While I like the idea of being sympathetic, there is such a thing as maudlin sympathy or soft credit, and the credit man who is soft can make more trouble than the credit man who is intelligent.

S. NELSON CASTLE (Manhattan Savings Bank & Trust Company, Memphis): There is one question in regard to hidden losses and to profits not legitimately made which I don't believe we have covered: that is, the question of inventories. On a falling market we often find our customers inventorying their goods at cost and on a rising market, at market price.

We, of course, have the accepted theory of checking as far as possible, having that inventory taken at cost or market, whichever is lower. How far do you go toward requiring your customers to have a certified public accountant make an unbiased audit of that customer's goods when he makes his audit?

MR. KIMBALL: That is a tough one. There is much debate among the accountants themselves as to how far their responsibility extends in regard to inventory. Of course, theoretically, we should like to have an accountant take the inventory and certify absolutely on his own responsibility. That is ideal, but, in spite of the fact that I should like to see it, I am not a bit convinced that it is the duty of the accountant. The accountant's job is, I think, not to certify to a thing in detail, but to express a reasonable opinion from an intelligent study of the facts, that the facts presented are correct, and to say exactly what the facts presented are, so that the banker will not think he

means one thing when he really means something else. As long as we know the basis upon which the inventory is taken, as long as we are satisfied that the accountant has used reasonable precautions in certifying to that inventory, I think we must be content.

MR. CASTLE: Another question along that same line: We have an argument with our certified public accountants every year as to how the matter should be handled. We often

find in statements so-called window dressing on December 31, especially in the inventory. They show the inventory rather low and the accounts payable correspondingly low, which, of course, increases their current ratio. It may be that that company has goods ordered, however, for January 2, 3, or 4 delivery. We have had a good deal of difficulty in getting our accounts to list that in the balance sheet set-up.

The Property Statement As an Aid in Solving Customers' Problems

By ALEXANDER WALL

SECRETARY-TREASURER OF THE ROBERT MORRIS ASSOCIATES,
LANDSDOWNE, PENNSYLVANIA

Address before the Denver Departmental Conference

Mr. Wall presents his reasons for believing that the current ratio in itself is not sufficient analysis of a statement, and he suggests other ratios to be used as supplements to this. He advocates the use of ratios of net worth to debt, of inventory to sales, of sales to receivables, of net worth to fixed assets, of sales to net worth.

Mr. Wall explains that the current ratio, when not supported by the use of other ratios, can be doctored; he gives an interesting example of a manipulated condition in which the figures were perfectly honest.

In closing, Mr. Wall reminds us that no proportion is standard at any time for all industries, or for any one industry for all time. "We can develop common figures that can be used to determine whether the proportions of the single company are reasonable; and by means of these figures, we can appreciate a weak condition and suggest to borrowers things they might do to bring about a better condition."

WHAT I am going to start with is the analysis of a financial statement, and I am going to take it up historically because that is the way the thing developed. The analysis of a financial statement is a historical growth within the period of my own experience of department work. Twenty-five or thirty years ago the comparison of financial statements really had its beginning. Prior to that time the credit man read the statement just in the way we read the newspaper.

The poor benighted borrower walked in with a financial statement, gave it to the credit man, and the credit man gave it the once-over and stuck it in the file. He might just as well have put it in the wastebasket. All he did was to glance

over it. He did not coordinate it in any shape or manner with any other facts or its own facts but took it as a bit of news, and at that, rather as headline news instead of reading through the article. I would wager that of the ordinary readers of newspapers, 75% read the headlines and the first ten lines, perhaps, of the general article. Those who are interested in golf, of course, read the golf articles; those interested in society, read of the social events; and those interested in fashions, read all the style news; and so on down the line.

Newspaper reading is very superficial and twenty-five or thirty years ago the reading of financial statements was almost as superficial. About thirty years ago some person

had the conception that statements should be read in continuity, that they should be so handled that the statement of this year should be compared with the statement of last year, the statement of last year with that of the year before, and so on. The statement of figures was set down on a comparison sheet year after year or period after period or when a statement could be obtained. Sometimes there was a lapse of two or three years; sometimes they were complete statements; sometimes they were very sketchy; but anyway they were put down in comparison.

TWO TYPES OF ASSETS

That lasted for five or six years, and then another student of credit added something to the technique of statement analysis. He realized that there were two types of assets: those that in the ordinary course of business liquidated and turned into cash and became usable for the payment of debt, and those that were fabricating assets that did not so liquidate, excepting through depreciation and wear out, but that in themselves did not turn readily and in the ordinary course of business into cash.

And so they segregated the current assets from the fixed assets. Right today there are still many credit men who befuddle current assets with something else. Within ten days I have had an argument with four or five of the leading accounting concerns of the country as to whether such an item as the cash surrender value of life insurance in the setting up of the statement, which they render to their clients to bring to us, should or should not be classified as current assets.

Personally, I do not believe that it is sound sense or good analysis to call this a current asset. Life insurance is carried to protect the continuity of management. Very often we are willing to loan money in excess of what the figures might indicate to be a fair loan because we base our judgment on all this economics that has been talked about or sense that the management is going to be able to earn itself into a position to justify such a loan. In order to protect ourselves up to the time of their getting into that position, we insist on an insurance policy, so that if that management should die, there will be coming into the estate a sufficient amount of money to liquidate that debt. It is insurance; it is credit insurance of the highest type.

That insurance policy, after a number of years, acquires a cash surrender value and this is a perfectly quick value. It is something that can be drawn against nearly as quickly as the cash in the bank as a physical possibility, but as an economic and credit possibility, it cannot be so drawn upon, because the moment the policy is surrendered in order to acquire the cash surrender value the protection is eliminated, and if the protection is eliminated, the risk becomes an unsound risk from the analytical standpoint; therefore the policy cannot be surrendered because we need the protection. Therefore, this item from the credit standpoint cannot be turned into cash in the ordinary run of business, and therefore, although perfectly quick, it is not current. That is pure logic, and still credit man after credit man, accountant after accountant, is confusing current and quick in the definition of assets.

An asset can be perfectly quick and not be current. It may be current and not so quick. There are plenty of inventories, as we were saying a few minutes ago, that unquestionably in our analysis we put in the current assets. Try to sell some of them for cash in a couple of days! If you can get twenty-five cents on the dollar for them as they are listed, irrespective of whether our accountant friends have certified to their proper listing or not, you will be doing well. You will find they are not as quick as they are treated in the books. Take them out and treat them as goods and find out about them. So you have quick assets that should not be considered current and you have current assets that are not quick.

In the early stages, twenty-five years ago, it was found that in making subdivisions one bank called them quick assets and another called them current until the two words were used interchangeably. They were supposed to mean the same thing and it is a uniform inheritance we are suffering from today. Anyway, they did divide the assets into current and non-current or fixed.

HOW THE CURRENT RATIO GOT ON TOP

Then they divided the liability side of the statement into three sections: the current liabilities, those that have to be paid within a short time; the funded liabilities, those the payment for which had been deferred to some more remote period; and then the net worth. At the moment I am not talking about certain reserves, but those three main divisions on the liability side of the statement.

The next step then was to insert at

the bottom of the comparison sheet a line, current assets, with a line underneath, current liabilities; then the excess quick, which is a mixture of phraseology, or excess current, which we call free working capital today, the difference between current assets and current liabilities. The only reason we put current assets on top was that everybody knows they ought to be more than current liabilities; when you subtract you put the larger amount on top.

That is the way the current assets got on top. And then somebody conceived the fact that it was not the difference in dollars between current assets and current liabilities that made the big difference after all. That amount of free working capital, so to speak, was not the thing by which you measure this current position.

Take a company with \$200,000 current assets and \$100,000 of current liabilities and the margin is \$100,000. Take a company with current assets of \$1,000,000 and current liabilities of \$900,000 and the margin is \$100,000. When you were talking about excess quick, as the phrase is used, the excess quick was the same in dollars. Unless you went back of that position you might conceive of one of the two companies as being as good as the other. The conception developed that it was the proportion that existed between the two that was the important thing. One had to be in reasonable proportion to the other for us to call the condition sound. With the inception of that idea happened one of the most confusing analytical blunders, from the statistical standpoint, that has happened in the whole history of analysis. Since we were in the habit

of placing current assets above current liabilities when the phrase expressing the relationship between these two items was developed, the current assets were put on top of the fraction and current liabilities on the bottom. This happened simply because that is the way they had been arithmetically. It is purely an accident and absolutely contrary to intelligent analytical procedure.

Take a current ratio of two for one. You can compute immediately that those current assets under the hammer in liquidation have got to bring fifty cents on the dollar to produce an amount large enough to pay out the current debt. That is easy. But when you have current assets of \$327,000 and current liabilities of \$162,000, how many cents on the dollar do the current assets have to bring to pay the current debt? You have to divide it the other way round. The current ratio should never have been expressed as it is. There never should be a current ratio of two for one. Current ratio of two for one should be expressed as a 50% current ratio in which you would divide the current liability by the current assets, and find that the current liabilities are 50% of the current assets; therefore current assets would have to liquidate at fifty cents on the dollar to pay out.

OTHER RATIOS MUST BE ADAPTED TO FORM OF CURRENT RATIO

If that had been the procedure from the start a great deal of the confusion in the use of the current ratio would have been eliminated right at its birth. I am mentioning that, not in any hope that we can

reverse this procedure. It is hard enough to get people to adopt new methods without getting them to upset old methods that have been in existence and in application for thirty years or more. I mention it simply to show to you that in its original development there is a stepping over from looking at the dollar figures in bulk to looking at the statement in its proportion. Starting out as an experiment, the current ratio was born like Topsy in Uncle Tom's Cabin. She was just born; she was an accident. Nobody knows where the current ratio came from or why it was developed in that way. It was just an accident. We cannot change it; we have to adapt the rest of our analysis, accepting it as a fact in use which makes it necessary to accept other misapplied proportions, which I will talk about a little later.

That current ratio business went along for a good many years. I know I inherited it when I went into the credit department. I was told that if a company showed a certain current ratio I could go home and sleep at night; that if a company did not show a certain current ratio I had better go home and stay awake and worry about it.

Worry does not do a bit of good. The credit man who is going to worry, and I use it in the strict meaning of the word, is not going to earn his salt, because if he cannot go home and get a good night's sleep because John Rose is going to "bust" tomorrow, somebody else is going to slip something over on him while he is sleeping in the morning. One of the best friends I ever had told me that work would never kill anybody, but that worry was the thing that incapacitated. I believe that is true.

We must not carry our customers' troubles home in order to have our wives solve them for us. They should be left in the office, and we should go home and get a good night's sleep.

Back in 1905, 1906, 1907, and 1908, there were some pretty troublesome times. I can tell you a good story about some clearing house certificates that gave us quite a lot of worry in 1907. We have not had those, I am glad to say, recently. One of the leading Milwaukee newspapers reprinted and reproduced one of them, and our exchange man clipped it out of the newspaper and spent it for lunch. We have relieved ourselves of that sort of thing. We have to pay for our lunches even in the depressing times of today.

Back in that time some of us began to wonder whether or not the current ratio was really the little tin god that our ancestors told us it was, whether or not the current ratio could possibly measure all the good and all the bad there was in a statement, whether it was conceivable that the current ratio covered all the sins of the borrower, or whether there might be other proportions—in other words, whether we should study the statement from more than one viewpoint.

We began to experiment first, to see whether the current ratio was sound, and then whether or not there were other proportions. I am going to name the proportions we have been working on, not in the order of their historical development but in the order more or less of their significance.

RATIO OF NET WORTH TO DEBT

In any operating concern there are capitals of two ownerships. A company starting in business raises a cer-

tain amount of capital. It belongs to the partners, the individual, or the stockholders. It is their money; it is their capital and they are putting it into the business to use as a basis of the operations of that business. Very rarely do you find a concern that can develop its business to a really profitable volume using only that capital. They have to have additional capital. They have to use more than what they, themselves, put into the venture.

Now that may be represented by credit extended by the bank on straight loans, or credit extended by the trade on open accounts, or any other of the credit mechanisms, such as acceptances or items of that kind that can be used to secure the possession of goods that go into the processes of fabrication, through them into the process of sales distribution, from which funds are received finally with which these obligations are paid.

DEBTS REPRESENT CAPITAL

From the standpoint of economics, the debts of a company represent capital just as surely as the net worth of a company does. In all its essentials the debts of a company represent assets on the assets side of the statement just as surely as the net worth does. You cannot take the ordinary financial statement of a cotton mill or a department store or a haberdashery, walk into that company and say, "This bolt of goods, these couple of bales of cotton, this two and a half gross of neckties, is absolutely the result of capital expenditure on the part of the owners alone." You cannot say, "This does represent assuredly a part of the net worth." So segregated, it may represent part of the debt, because on the asset side

you do not carry tags, as is done on baggage. The assets are not labeled.

But on the liability side of the statement the capital is labeled, the net worth belonging to the company and the debts belonging to the company's creditors. So there are capitals of two ownerships used rather indiscriminately in the affairs of the business as long as the business is reasonably sound. The proportion between those two ownerships is a very important thing. The value often determines who controls the future of that business. It determines who is running the business. We hear comic stories of banks going into the shoe business or something of that kind, meaning that the money the banks have advanced for that company to use has become so absolutely tied to that business that the banks cannot get it back and that therefore they are theoretically partners in the industry. Very often they do have to run the business before they do get the money back or take their licking.

So that proportion between the net worth, the owners' capital, and the debt, the creditors' capital, is a highly significant thing.

VARIATIONS IN DEBT RATIO

How many of you and how many of your associate officers have had the poor borrower sit down alongside your desk and you have said to him, "You are top heavy with debt"? The borrower did not know what it meant, and unfortunately a good many men who use the phrase do not know what it means. It is banking vocabulary used very often to befuddle a borrower and make him think that a banker is a "wise guy." Talk a language that is over the head

of the borrower, in other words, so you can sort of hypnotize him and get him to do what you want him to do.

The wise borrower would come back and say, "Mr. Banker, maybe I am top heavy with debt; perhaps that is so, but how does my top heavy debt condition compare with the condition I was in last year? Am I more top heavy or less top heavy, and how do I compare with the man down the street? Am I more top heavy with debt or less than he is? Am I getting lighter on this overburden or is the burden getting so heavy it is going to crush me?"

That is disconcerting to the analyst who is using that phrase of criticism with nothing back of it. Suppose that the net worth a year ago was twice the debt, that the ratio between the two was \$2 for net worth to \$1 for debt. We speak of that as a ratio of 200%. Suppose that the ratio of net worth to debt is as \$1.50 of net worth to \$1 of debt. The net worth is less in proportion to the debt. That company is increasing its debt load. Its debt rests more heavily on the situation than it did the preceding year, and you can state rather definitely to the borrower, "Your proportion of debt last year was 200%, and this year it is 150%. You are weakening. You have weakened fifty points."

It is the substitution of a very definite comment for a phrase that is all-inclusive. You have two borrowers. One is asking about the man down the street, not by name, perhaps, but by inference. You say to this man, "The proportion between your net worth and your debt is one and one-quarter to one, and that of the man down the street is one and

three-quarters to one. You are more top heavy than he is by about fifty points."

You have something definite to work with. You can trace the movement of capital ownership that is being used in the business by the fluctuation, the rise and fall of this ratio.

For myself, and I am speaking only for myself, I think that the computation and recording of current ratio by itself alone is a very dangerous thing because it overemphasizes that one proportion. If I were to have prepared for my use an analysis sheet and the chiefs who were over me said to me, "We wish to have a current ratio prepared and entered each year on the bottom of the column for that year of this statement and we will have no other ratio entered there," I would say, "I refuse to compute a current ratio alone. I must have at least this additional ratio that measures the ownership of capital for such concerns as use it."

CURRENT RATIO NOT ALWAYS SOUND

I would say that for this reason: how often have we seen a company get out a bond issue or a mortgage, a funding operation to improve its current position, which is very often a window dressing proposition. A company finds that its current ratio is lower than is acceptable to a bank or to the trade and so they get out a cleverly funded debt, some kind of obligation that they will not have to pay for fifteen or twenty years. They use the proceeds and subtract that amount from the current liability. They have not affected the current assets and they raise the current ra-

tio, sometimes inordinately. They show a wonderful current ratio, and if you are relying on the current ratio you may be absolutely fooled through that kind of operation in your conception of the fundamental underlying strength of the situation. It is a very commonplace method of satisfying the banks.

Unfortunately when that sort of thing is done, if \$100,000 is going to be needed to reduce the current liabilities enough to produce a satisfactory current ratio, such a man is very seldom willing to limit his funded borrowings to \$100,000; for good luck he borrows \$150,000 or \$200,000, if he can.

After the operation is over and the current ratio is fixed up, the worth to debt ratio may actually decline in the face of a rising current ratio, as in the transformation more debt has been added, because a company that owes on funded obligation owes that money just as much and just as surely as it does on a current debt. It is an obligation that will come home to roost some day.

Borrowing on a funded basis does not relieve the concern of the debt. The debt is there and if that has fixed up a current ratio and the current ratio is tabulated and carried on from year to year and nothing is done to call attention to the fact that the capital position is no stronger, or may be weaker, you are only building a house out of bricks of straw. You are only fooling yourselves by a lack of attention to those underlying and fundamental situations.

In mentioning this worth to debt ratio I want to go back to the fact that the current ratio was developed upside down historically, because I find, and I think logically so, that a

great many men today are developing the relationship between the borrowed capital and the owned capital instead of developing a ratio of worth to debt. I wish it could be that way. I think theoretically that is the proper way to do it. I think that practically it is a silly way to do it, because you then have a current ratio and debt to worth ratio running contrariwise. You have a current ratio getting larger to indicate strength and a debt to worth ratio getting lower to indicate strength. You have ratios moving in opposite directions, which again is liable to minimize the result of the analytical value of the use of the two ratios, one unconsciously offsetting the influence of the other. I think it is important from an analytical standpoint to have the ratios move in the same direction for the same reason, going up for strength and down for weakness.

I am sorry that the first mistake compels the acceptance of what might be called a second mistake in the development of that ratio, but that, nevertheless, is a fact.

.RATIO OF INVENTORY TO SALES

The next conception of proportions was based on the phrase "over-inventoried." In 1920 we used that phrase a good deal. We told customers they were over-inventoried. A few people were using ratios at that time, but there was no definite method of expressing over-inventory or reasonable inventory or moderate inventory, no method of relating them to each other as between different companies.

Why do we have inventories? If you go back and develop this thought in pure logic, you find that inven-

tories are acquired by companies in order that they may be sold, presumably at a profit in the ordinary course of business. That fact relates inventories to sales and you can measure the reasonableness of an inventory by its relation to sales. Divide the sales by the inventory. You do not get a physical turnover because sales are at market price and inventories should be at cost or market, whichever is lower. It is not a physical turnover but it is a measure of turnover activity as between any two, three, or four successive years, or as between two companies, or as between the real conditions and a window dressing condition.

A CASE OF MANIPULATING THE CURRENT RATIO

Mr. Kimball's chief, Jack Eaton, one of the most intelligent men I know, sent a statement down to me some four or five years ago asking me to analyze it for him. This statement showed really a nice condition. It showed a current ratio of 245%, 2.4 to 1. It looked nice. There was only one thing I could not understand. It had sales of about \$1,200 for every \$100 worth of inventory. It looked to me as if they were doing much more business than the amount of inventory they had on their books would seem to indicate as possible. I told Jack to ask the manager how it was possible to do such a large volume of business on such a small inventory.

This was about the answer: About the fifteenth of November of each year the management called in all the crew from the purchasing department and said, "Anybody who buys a nickel's worth of merchandise during

the month of December will be fired." He did not put it that roughly because he was a New Englander. He said it in Bostonese, which is a polite language. That, however, was what he got over, that during the month of December they must not buy even a nickel's worth of merchandise.

Then he brought the sales department in and said to them, "If you don't sell twice as much merchandise in December as ever before, you will be fired." Then he got the credit department and said to them, "We want you to check up on all your collections and get in all the collections you can during the month of December." As fast as they got \$4.50 they went to the bank and paid off some of the bank indebtedness during the whole month, and by the thirtieth of December they had built up a very nice picture.

On the second day of January they released the purchasing agents, who went out and bought their heads off, and by the fifteenth day of January they were back to a normal or reasonable inventory.

Now in dollars the merchandise of that company showed, say, \$350,000 on December 31, due to that method of transacting business; by the fifteenth of January that inventory was around \$850,000, with concurrent increased debts. That is window dressing; that is a manipulated condition, honestly manipulated. The figures were perfectly honest. If you had all the accountants in the United States go over it, they could have found no comments against the inventory. Of course, all the people from whom that company was buying knew that on the second day of January they had better have the

salesmen in there, but there was no commitment to buy. So, on December 31, it was a perfectly honest though somewhat manipulated statement.

When this round half million dollar increase in inventory was written into the December 31 figures, the current ratio was changed. That is the real danger in using the current ratio alone.

That company was good. Taking a second view of the figure facts, that company was manipulating the situation. They are not doing it today. They could not exist on the capital they had and transact the volume of business they were trying to transact. They could not carry their operations along at a profit on the volume of business they could transact on the capital they owned.

So, there again, you have an instance of the weakness of relying on what may appear to be a sound current ratio unless you examine the underlying factors to determine whether or not the current ratio, as exhibited, is really a sound exhibit. You have to know whether the other proportions are proper.

RATIO OF SALES TO RECEIVABLES

You hear another expression. You hear people say that this, that, or the other merchant is in the banking business, meaning that he is carrying his customer inordinately, that he has too many accounts receivable. That is very similar to the ratio between sales and merchandise. Receivables are the sediment of the sales campaign. They are the mud that has settled to the bottom and has remained uncollected. Receivables are nothing but uncollected sales, and when that

sediment rises too high in the glass you have a very muddy condition, so that the relationship of sales to receivables is a very valuable proportion by which to test the soundness of the receivables.

It is also a very valuable thing to use when it is inordinately high. If you find a man having sales of twelve or fifteen times his receivables in an industry where it is difficult to find some about six or seven times the receivables, you ought to wonder whether some discount company hasn't the receivables. When a company seems to be able to do \$100,000 worth of business and have only \$10,000 worth of unpaid sales, whereas you would expect \$20,000 to \$50,000 worth of receivables, you ought to wonder who has the other receivables and under what conditions; because when receivables are hypothecated, they are normally not sold really as an outright sale, but they are hypothecated under a substitution contract, so that whenever any particular receivable goes to a discount company and it is not paid within a reasonable time after maturity, the owner has to take it back and substitute a better receivable. When that condition exists, the remaining visible receivables of the company are nothing but dregs. You can check that statement pretty readily if you make an understanding study of what the relationship ought to be. If the company does not live up to something approximating a reasonable relationship between its sales and receivables there is something wrong. Either they are extending credit on too long terms or they are taking the best receivables away from underneath your risk and giving them to somebody else. The proportion is wrong.

RATIO OF NET WORTH TO FIXED ASSETS

There is another test, one that we are talking about still as a result of the war. We talked about it a good deal in 1921 and 1922, and we are beginning to talk about it again: overcapacitation; overinvestment in plant; the ability to produce four times as much as we can consume.

What is overcapacitation anyway, outside of the ability to produce more than you need? What are plants? How should they be financed? Fixed assets or capital assets? Normally, excepting for certain funded operations, fixed assets should be provided for by the net worth. There is a definite relationship between net worth and fixed assets. They are brothers and sisters; they belong absolutely in the same family.

The relationship of the net worth to the fixed assets will help you sometimes in analyzing this profit and loss statement. The relation that exists between net worth and fixed assets tells a story, because I think there are two things to do with profits. The making of a profit is an essential to business. That is why concerns are in business, to make a profit, and so the establishment of the fact that a concern is making a profit is a highly important thing. I agree with Mr. Kimball 100% that far, in spite of his other views on the profit and loss statement.

HOW ARE THE PROFITS SPENT?

There is a second step. How are the profits spent? After you have the profits, what do you do with them? I think that is almost as important. Now, the net worth, as I

see it and as I speak of it when I am talking, is the horsehair cushion on which the creditor sits which makes credit-granting a Morris chair proposition, a comfortable thing to be in. The size of the net worth may be represented by the thickness of the cushion and the breadth of the cushion. The kind of asset represents the stuffing that is inside the cushion.

If you see the net worth go up, if you see the net worth increasing as between two years, you may do as Mr. Kimball said and say, "This concern is making money and therefore it is meeting the test of being in business and is a satisfactory risk."

As a first supposition, too many (not Mr. Kimball) analyze only on that basis. It might be a good deal like this. Suppose you left home in the mornnig and that good old comfortable chair in which you read your paper was there. During the day an upholsterer came in and when you got back home at night the cushion, that had been packed down and sagged a little bit, was thick and round on top. You say, "Oh, that's fine! I'm going to sit on this cushion and read the paper; it's a lot bigger cushion than the one I sat on last night."

The net worth of the company is bigger. You put on your carpet slippers and get the paper and get into your smoking jacket and get your pipe; you get the proper light and because it is a nice big cushion you let yourself drop and you find you are sitting on a lot of bricks and mortar. They represent the investment of that increased net worth in fixed assets. I ask you if the fact that the cushion is bigger proves it is more comfortable.

I think you can have a bigger net worth this year than you had last year and yet if every time a dollar is re-

ceived another brick is bought, while the net worth is bigger, it is just that many more bricks for you to sit on. If there is earning capacity and it continues long enough, and the amount of bricks they want is secured, and then they put some of the additional dollars into merchandise and accounts receivable and cash into the bank, over a period of years, all well and good. But you must not let just an increase in net worth get by unless you are sure that increase represents at least an equivalent in the quality.

I test that myself in the relationship of net worth to fixed assets. If the amount of the net worth has gone up but its proportion to the fixed assets has gone down, I am at least a little bit quizzical in my acceptance of the proposition that the increase in net worth puts me in a better position as a creditor. I may have more net worth that will bring fewer cents on the dollar, after all, if we have to liquidate the operation.

RATIO OF SALES TO NET WORTH

Then there are two other phrases we hear mentioned very often. We hear it said that a concern is overtrading or dying of dry rot. What is overtrading anyway? How is it measured, how can it be recorded from year to year to see whether or not the firm is continuing to overtrade or whether dry rot is eating into the core of the situation?

Overtrading means doing too much business for the amount of money you have in the business, trying to make your dollars turn too fast, trying to get too many turnovers of your net worth, trying to let somebody else carry the debt loan—because you will find the worth to debt position gen-

erally weak in an overtrading situation. A concern is not content, or perhaps not able, to provide enough net worth to support the volume of business it is able to get. Very often you will find that condition existent in a concern that has been organized by salesmen, men who are sales conscious, who think the only idea is to get the business, who have no idea of financing it after they have it. They hope that the bank will do that, so they go out and get all the business there is in sight and have no conception of the fact that there is a relationship between the volume of business which they can transact soundly and their own net worth.

Then you will find the other concern that is going to seed, in which the net worth is hardly turning over at all. That is generally the result of an incompetent inheriting the business of his grandad, or very often it is worse than that; it is the grandad who refuses to die and let his grandson inherit it. He is a fellow who has gone along and made a fair amount of money. He is sitting comfortably and does not try to grow. He says, "Well, we did a pretty fair amount of business and let's go on." Complacency! To justify the investment of money in an enterprise, that money so invested must have a reasonable sales result, and unless that is there, there is no economic justification for having that amount of net worth in a business. Better take some of it out and put it in a new business where it can work. Try developing and recording a ratio of sales to net worth.

SALES AND PLANT RELATIONSHIP

There is another way of measuring overcapacity of a plant. Why do we

have a plant? To manufacture something; this results in the production of something we hope to sell. So there is a relationship between the sales and fixed or plant assets, and if every dollar invested in plant assets does not produce a reasonable amount of sales dollars, what is the sense of having that plant?

You will find this thing in analyzing: that where there is a sellers' market condition, when business is booming, the first reaction of a man is to increase his plants in order to get bigger production.

It is a well known economic fact that in periods of great business activity, the efficiency of production decreases. Things get at loose ends. It is not so necessary to have everything tight. You can sell the stuff anyway; go ahead and make all there is in the world. Then comes the slack period. The fellow who has built plants finds he has too many machines.

I remember—if I may be excused from introducing points that are purely personal because they show what I am trying to get over on this plant business—when I was in Detroit we had a little printer. He had one rather large cylinder press. He came down to the bank to borrow \$8,500 to buy another one. I asked him why he wanted another one. He said that he could not turn out with his present one the amount he could sell. That was in 1916. He was doing a nice business in his shop. It was a comparatively small shop.

I said to him, "Did it ever occur to you that instead of buying another press that works only one-third of the time you hire another press crew and run the press from eight o'clock in the morning until five

o'clock at night, and then start another crew at about six o'clock and run it until two or three o'clock in the morning, making that press work sixteen hours instead of eight?"

He had never thought of it, but he did that. During the period from 1916 to 1919 his business prospered. Then I left Detroit. About 1922 he was taking a vacation; he was going to play for a couple of months. That was a cold winter in business and he was going to play. He telephoned me from Philadelphia and wanted me to come in and have dinner with him. I said, "How's business?"

He said, "I have eight of those presses like the one you wouldn't let me buy."

I said, "Are they all in grease and under canvas?"

"No," he said, "all eight are working eight hours a day, and a couple of years ago seven of them worked twenty-four hours a day and every day we kept one off the work list eight hours to fix it up. We had three crews on every press and now I have one crew and as I figure my cost on the one eight-hour day, I got my other sixteen hours a day at a really greater profit because I did not ask them to absorb the overhead. My presses are working their full eight hours a day because you gave me the tip in 1916 that presses could work sixteen or eighteen hours a day."

That is the new attitude in credit work. When a man comes in to increase his plants, it is not the thing to do to let him increase them and then when the depression comes criticize him. Overinvestment in fixed assets is the result of the inordinate and ever present desire of man in periods of prosperity to get a bigger volume

of business by the easiest method, which is to get more machinery and more plants. The best way to get that is by more careful efficiency or management and then in times of depression you will not have overcapacity. You can measure capacitation by sales and plant relationships. That is the ratio method of analysis.

We have added recently the relation of profits to sales and profits to net worth, following in the lines of the idea advanced by Mr. Kimball, that unless a concern can make a profit and make it in a reasonable proportion, there is no object in that concern's being in business. It is foolish to put money into a concern that is not earning a reasonable, commensurate return. Better keep the money out of that kind. So, sales to profit and sales to net worth are two highly important ratios.

CURRENT RATIO NOT THE SAME FOR EVERY BUSINESS

I said in the beginning that current ratio was a foolish thing if an analysis was based on it and its movement alone. That is only part of the story. It is perfectly foolish to accept a current ratio of two for one, three for one, or four for one as a proper current ratio unless you know whether it is a proper current ratio.

I had a very good friend when I was in Detroit whose desk was separated from mine by four feet and a fire wall. He was in the bank next door. His early training had been in the packing business. He would buy the note in the open market of any packer because he thought he knew something about the packing business.

My father was in the grain busi-

ness so I would buy the note of almost any milling company because I had an idea I knew something about the grain business. We used to have lunch together and fight out the relative merits of these two industries.

He used to say this to me, "Now, in the packing business the assets are very liquid. A packer can sell his meat off very quickly and it is the custom in the trade for his buyer to pay him very quickly; therefore, because the assets are so very current, it is safe to do business with a packer on a low current ratio and that opens up a very nice market for my excess funds."

If you stop to analyze that situation, the logic is unsound. If the assets are extremely current and do turn into cash in a very short period, they become available for the purchase of more merchandise. They turn over faster. Logically if the assets are so very quick, you ought not to have to borrow so much to transact a large volume of business. I can tell you quite confidently a current ratio of two for one for a packer is not nearly so sound as the same ratio for a cotton mill. The two things do not measure.

For example, take the millinery business and the hardware business. I am glad we have some of the ladies with us because they will bear me out in part of my argument. Inventory is a large part, very often, of current assets. I ask the ladies present: who would buy one of these large Gainsborough picture hats in a period when small hats were the style? I tried it once. I was going through Wanamaker's with Mrs. Wall. She was going to buy a hat. I called her attention to a table full of hats. That was my first mistake. They should

not have had those hats on the table; they should have been in the case. I called her attention to one of the hats that was a nice large one, and very pretty as far as I knew anything about it. She said, "If I had been down here about four months ago I would have been glad to buy one of those hats but that style is *passée*." So we went over to the counter where they had the hats in the case and bought one. It would not shed rain any better; the material wasn't any better; but the one on the table didn't "click." I could not get away with it.

We will leave that for a moment. Suppose you put your automobile in a garage yesterday and some mechanic liked your monkey wrench and after he had fixed up a couple of bolts with it, he put it on the shelf and not in your tool kit. In the morning you wanted to tighten something up and missed the monkey wrench. I suppose all the men in the room would go down and say, "I must have a pink monkey wrench. I can't use a green one. I must have a monkey wrench with a walnut handle. I can't use one of mahogany because they went out of style last month."

If the current ratio is right for the millinery business, that is no reason to assume that it is right for the hardware business. They have different conditions that produce different strains and it is just as silly to measure a statement by the conception of what the current ratio ought to be, gained from examples of cotton mill statements, when you are looking at the statement of a department store, as it would be to limit your examination and judgment of the soundness of the risk by use of the current ratio alone.

NO PROPORTION STANDARD AT
ALL TIMES OR FOR ALL
INDUSTRIES

No proportion is standard at any time for all industries. Neither is a proportion I have spoken about standard for any one industry for all time. Each period of the economic cycle, each movement of business, each year's operations produce on December 31, at the end of that period, an entirely different and new set of proportions that can be analyzed by trades. So we can find, not the beautiful theoretical ideal, but what the trade as a trade shows, so that when we measure up a department store on December 31, we will not be measuring it against a whim or a fancy or a preconceived notion, but we will be measuring it up by what was common for department stores on that particular December 31, and

then we will be getting somewhere. We will be introducing the beginning of a science in analysis.

Science means the assembly of concrete, positive, accurate facts, and the handling of facts. My friend in Detroit thought a current ratio of two for one or two and a quarter or two and a half for one in the packing business was perfectly sound. But in that business it is more common to find a current ratio of three to one or two and a half to one. For the last four or five years a higher current ratio has been more usual.

We can develop backgrounds or common figures that can be used to determine whether the proportions of the single company are reasonable; and by means of these figures, we can appreciate a weak condition and suggest to borrowers things they might do to bring about a better condition.

Handling Credits in a Group Banking System

By GEORGE S. ECCLES

VICE PRESIDENT OF THE FIRST NATIONAL BANK OF OGDEN, OGDEN, UTAH

Address before the Denver Departmental Conference

Mr. Eccles outlines methods used by various groups in handling credits, by giving the answers of different banks to eight questions which he submitted to them:

1. What control does the head office or parent bank exercise over the credits of the branch or member bank?
2. Does the parent bank keep central liability ledger and central credit file?
3. Does the parent bank make periodic credit examinations?
4. How are excess loans handled: does the receiving bank have the right of rejection of any line; does the sending bank subrogate its portion, in case a loss develops in the credit line?
5. Is statistical record kept of diversification of credits extended by the entire system, so as to show amounts of money invested in each line of industry, such as agriculture, live stock, manufacturing, retail or wholesale business, and so forth; also as to eligibility and non-eligibility of paper?
6. In case a member bank becomes overloaned, does the bank sell its paper without recourse to some other member bank in the group, borrow money and pledge its paper as security, or does the head bank place a temporary deposit with the member bank?
7. In group banking, is each member's liquidity considered separately, or is the liquidity looked at from the standpoint of the group?
8. Does the parent bank formulate loan policies for its members; if so, are written instructions given?

Mr. Eccles furnishes also charts showing exactly how group banking records are kept.

IN dealing with the subject of Handling Credits in a Group Banking System, we must first realize that group banking as it is known today is a new type of banking, the oldest groups dating back only a few years. In fact the largest groups are less than two years old, and this type of banking is growing very rapidly. A recent report of the

Economic Policy Commission of the American Bankers Association, presented at the Executive Council meeting last month, indicates that they feel that the most important development affecting American banking in recent years, is the rapid growth of multiple banking organizations in the forms of group, chain, and branch banking systems. Estimates show that there are

269 group or chain systems, comprising 1,922 banks with aggregate resources of more than \$15,000,000,000. This type of banking is not limited to any one section of the country, as we find there are groups in every state of the Union, with the exception of six. This type of banking has proved its worth and will continue to grow, as there is a need in many situations for a change in our banking structure from the old type of unit banking.

EXTENT OF CENTRALIZATION

Even though the development of group banking has been somewhat standardized as to operation, we find that the policies in the various groups are quite different. In some groups there is a tendency toward centralized control and supervision, with each unit of the group leaning on the larger units in the system. In this respect they are being operated as nearly as possible like a branch banking system; however, each unit, from the requirements imposed by law, has its own corporate entity, with its individual capital and surplus. It has its own legal loan limit, which of course is not the case with branches in a branch banking system.

Then we find groups that are very much decentralized, although the ownership of the various unit banks is held by the same group of stockholders, either through a holding company or through a stock trust arrangement, as is the case in the other type of group banking. Only in this respect can such an aggregation fairly be termed a group banking system. In such a decentralized type, each unit operates in practically the same way as it did prior to entering

the group. There is no effort made by a head office or a head bank in the group to dictate the policies of the member banks; there is no control of credits, no centralization of reserves, and no general auditing or examining system. The operations of the various units are not standardized. This type of group banking is not the type which we like to consider when dealing with the operations of a group system. The tendency is to get away from this type as it really does not give the benefits that should be derived from group banking.

CENTRALIZATION TENDENCY

We find, however, the tendency is to attempt to standardize the operation of the units within the group, maintaining them as separate units, so far as the public and depositors are concerned, but so far as possible keeping a centralized control over them and from the standpoint of internal operations, operating them, so far as possible, as if they were really branches.

In some groups the centralized control is carried very much farther than in other groups; especially is this true in the handling of credits. There is, however, very little uniformity at the present time in the method of handling credits in the various groups, so in dealing with the subject which has been assigned to me, Handling Credits in a Group Banking System, I think it will be of interest to you if I outline some of the methods which are used and then give you some of the details regarding the methods which I think should be employed and which, I may say, have worked out to very good advantage over a period of several years.

ADVANTAGES OF BRANCH BANKING

This paper is not to be an essay on rules for passing on credits. That in itself is a prime point of difference between successful and unsuccessful banking, whether it be in the unit, group, or branch banking field. Some of the advantages in group or branch banking are the facts that better credit policies can be pursued and a greater diversification of credit is made possible. It is the duty of the management of the group banking system to see that these advantages are developed. If the credit needs of the community are not taken care of in a better way and the soundness of the unit increased, by the unit's becoming part of the group, or, in other words, if the banking needs of the community are not taken care of in a better way by the group system, then there is no reason for the existence of the group. By taking care of the credit needs in a better way, I do not mean simply the extending of more credit, as I do not think that in itself is taking care of the needs, but I do mean the extending of more credit, if credit is needed, provided this credit is extended wisely and based on sound credit principles. The unwise extension of credit, or the extending of too much credit, will in the long run shows its effects and some one will have to pay for this folly. Usually we find it resulting in a boom, based on an unsound financial structure, with the inevitable slump, or in most cases we find it resulting in a bank failure, with this accompanying economic loss and depressing effect on the community.

Enough control should be had in

group banking, through the head office or head bank in the group, so that experienced bankers, through the medium of an executive committee, can pass on to the units in the group the advice and supervision that are necessary to insure sound banking policies in each unit. This is not possible in the unit banking system, with the exception of the very large unit banks. The smaller unit banks cannot afford high salaried banking executives, specialized in their particular field, whether that field be certain types of credit, such as live stock, manufacturing, or merchandising, or whether it be in the investment field. But in the group, by the bringing together of many units, this is made possible, and the benefits can be had by each unit in the group.

This paper should outline to you the methods or ways by which the benefits of the group system are passed on to the units in the group, from the loan administration standpoint.

I prepared a series of questions dealing with the handling of credits in a group banking system and submitted this questionnaire to several of the group systems through the country. I also submitted it to some of the leading branch banking systems, as I was interested in learning the methods employed in the various groups and the main points of difference between the methods used in the group and branch systems. A review of this checking follows:

CONTROL OVER CREDITS

Question No. 1—What control does the head office or parent bank exercise over the credits of the branch or member bank?

Bank "A" reported that discretionary loan limit is given the managing officers of each bank. This limit is according to the size, the activity, of volume of the bank, and the ability of the manager. This is the limit upon which the local discount committee may act. Any line of credit above this amount must be referred to the head office. The limit is not based on the legal loan limit of the bank.

Bank "B" reported that local managers have full power to make loans up to the legal limit of the bank, subject to the approval of the local executive committee or board of directors. All excess credit lines must be approved by the parent bank or head office.

Bank "C" reported that the president or vice president at the head office must pass on all new lines in the branch of \$500 or more.

Bank "D" reported that the managing officers of the holding corporation and not the officers of the largest bank in the group are the ones who supervise the credits of the various banks. The credits of the various banks are left entirely to the local board of directors and officers of the individual banks. They have full power up to their legal limit, subject, however, to the supervision from the head office to see that loose credit policies are not being pursued. Excess credit lines are taken up with the larger banks of the system which pass on the lines for their own portfolios without referring the lines to the head office.

Bank "E," which is a branch system, reports that the loan limit is set according to the size of the branch, and the ability of the officers. Daily reports are made on all loans

made and reviewed by the loan officers in the branch management department of the head office. Before renewals are made, a review is made by the credit department of the head office and in case of any doubt on the line, it is taken up with the branch management.

Bank "F," which is also a branch system, reports that a discretionary loan limit is fixed for each bank, determined by the size of the branch, the size and character of the community, and the capability and experience of branch loaning officers.

Branch officers have full authority on loans up to the discretionary loan limit, subject, however, to the approval of the credit department at the head office, which department is responsible to the board of directors through the executive committee.

Loans in excess of the discretionary loan limit must have the prior approval of the credit department.

Bank "G" reports that the loan limit on unsecured loans is based on the size of the branch and ability of the manager. A complete report on all loans must be made to the head office and checked by it.

CENTRAL LIABILITY LEDGER AND CENTRAL CREDIT FILE

Question No. 2—Does the parent bank or head office keep central liability ledger and central credit file?

Bank "A" reports that all applications on loans over the loan limit of the member banks are submitted in duplicate to the head office, with financial statements and other necessary information, also with the recommendation of the local committee. This information is retained in the head office.

Regular lines should be approved early in the season so that the local manager can act quickly on applications of old customers. No central ledger is maintained.

Bank "B" reports that no central credit file or liability ledger is maintained by the head office. They are, however, considering the adoption of a system of central credit control and think that this should cover all lines of credit of \$1,000 or more.

Bank "C" reports that a central liability ledger and credit file are maintained on all lines of \$500 or more.

Bank "D" reports that no central credit file or liability ledger is maintained.

Banks "E," "F," and "G," which are branch banks, report that central credit files and liability ledgers are maintained on all commercial lines. Loans are reported daily to the credit department, and they maintain necessary files, containing supporting information on all lines of credit of \$1,000 or more. This information includes duplicate financial statements, copies of appraisements, explanatory correspondence, and so forth.

PERIODIC CREDIT EXAMINATIONS

Question No. 3—Does the head office or parent bank make periodic credit examinations?

Bank "A" reports that at the present time no credit examinations are made; however, they feel this should be done and are working on a system which contemplates a thorough credit examination at least twice a year.

Bank "B" reports that each bank is thoroughly examined by the audit-

ing department of the head office twice a year. The audit includes a full list of loans, with comments. Periodic visits are made to the unit by senior officers of the head office at least once in each three months, at which time important credit problems are reviewed.

Bank "C" reports it does not make credit examinations at the present time, but contemplates making one semi-annually.

Bank "D" reports it makes complete credit examinations at different periods, and also requires a copy of national and state bank examinations.

In the branch systems complete credit examinations are made periodically by the credit department of the head office.

EXCESS LOANS

Question No. 4—How are excess loans handled: does receiving bank have the right of rejection of any line; does the sending bank subrogate its portion, in case a loss develops in the credit line?

Bank "A" reports that all excess loans are carried by the head bank in the group, the volume of this type of paper not being large. No paper is placed with the other member banks. If the head office picks a poor loan, it must absorb the loss.

Bank "B" reports that all excess lines do not always pass through the head office or parent bank, but are approved by it and then are sent direct to another member bank, which is designated by the head office. However, the receiving bank must independently pass upon the desirability of the paper, and it has the free right of rejection of any participation. The class of paper thus

far placed in the member banks has not raised the question of subrogation in case of loss. This bank feels, however, that it would be right to have the originating bank subrogate its portion in case a loss should develop.

Bank "C" reports that all excess paper must pass through the head office and is placed by it in the member banks. The member banks do not always have the right of rejection in such participations. Member banks do not subrogate their line in case of a loss.

Bank "D" reports that excess lines are approved and carried by the head bank of the group, and in case of loss that bank of course absorbs it. The entire line is usually carried by the parent bank. The local bank seldom participates in any portion of the line when it is an excess line.

The problem of carrying excess paper is not present in a branch banking system.

RECORD OF DIVERSIFICATION OF CREDITS

Question No. 5—Is statistical record kept of diversification of credits extended by the entire system, so as to show amounts of money invested in each line of industry, such as agriculture, live stock, manufacturing, retail or wholesale business, and so forth; also as to eligibility and non-eligibility of paper?

Bank "A" reports that no record is kept at the head office of the diversification of loans extended in the entire system. However, at the present time, credit examinations are made and the loans are then classified as to industry. They do not feel that it is necessary to keep a record at all

times, because of the diversification of industry in the territory they serve. They do not feel that they will become too heavy in any one line.

Bank "B" reports that each member bank prepares its own schedule of diversification, and totals are compiled periodically for information of the head office.

Bank "C" reports that a quarterly recap of the various classifications of loans is made at the head office.

Bank "D" reports that head office, at the first of each year, makes a complete classification of the loans in the group.

In the case of the branch systems a record is kept of the credit lines according to classification. This is limited in some cases to lines in excess of \$10,000, while in other cases it covers all credit lines.

In one case a daily recap is kept of classification, which acts as a control ledger covering the central liability ledger.

OVERLOANING BY MEMBER BANKS

Question No. 6—In case a member bank becomes overloaned, does the bank sell its paper without recourse to some other member bank in the group, borrow money and pledge its paper as security, or does the head office or head bank place a temporary deposit with the member bank?

Bank "A" reports that secured paper has been purchased by the head bank without recourse. The head bank may also accept bills payable of the member bank, secured by a margin of collateralized notes. The head bank may also rediscount for the member bank. In no instance has the head office deposited money with

a member bank to replenish the reserve.

Bank "B" reports that a member bank may borrow or rediscount its paper with the parent bank or other member of the organization. In no case does the parent bank deposit with the member bank to assist it through its peak loads.

Bank "C" reports that a member bank may sell paper it has without recourse to the parent bank. The parent bank is the only bank in the group which borrows from the Federal Reserve or correspondent banks.

Bank "D" reports that the member bank, if overloaned, may rediscount with correspondent banks, or with the Federal Reserve bank. In some cases they may place their paper with the parent bank, but this practice is not encouraged. The parent bank or holding corporation never deposits with the member bank to help it over its peak load.

This problem of selling paper or replenishing of reserve is not present in the branches of a branch banking system.

LIQUIDITY

Question No. 7—In group banking, is each member's liquidity considered separately, or is the liquidity looked at from the standpoint of the group?

Bank "A" reports that each member's liquidity is considered, and they are required to maintain a liquid position by requiring seasonal loans to be liquidated, and surplus funds carried in commercial paper or call loans, so they will be available when needed.

Bank "B" reports that the liquidity of each individual bank is consid-

ered separately and it feels that if each bank is maintained in a liquid position, it will result in a sound condition for the whole system.

Bank "D" reports that each member bank to a certain extent stands on its own feet and maintains itself in a liquid position. It is the duty, however, of the head office to see that no member bank gets itself in an over-extended condition.

LOAN POLICIES

Question No. 8—Does the parent bank or head office formulate loan policies for its members; if so, are written instructions given?

Bank "A" advises that loan policies are not given in written instructions, but are uniform and are extended to the members through officers' meetings and are checked up by the examining department to see that these policies are carried out.

Bank "B" reports that no written instructions have been given regarding loan policies; however, they are standardized in the various units. The policies have been formulated as a result of conferences in which the managers and members of the boards of the member banks have participated. Each member bank has an advisory committee, and two members of this committee are directors of the holding corporation.

Bank "C" reports that loan policy rules are not written. They are practically dictated by the parent bank and enforced by close check of weekly reports furnished on all lines of \$500 or more.

Bank "D" reports that loan policies are left practically entirely to the member bank and its board. However, if credit examinations re-

veal loose loan policies, they are immediately checked up by the head office.

From the foregoing you can see that there is some uniformity in policies and practices among the various group systems, but the procedure followed to carry out these policies is not uniform.

CONTROL AS TO LOAN POLICIES

It appears to me that in order to get the best results from a group banking system, close central control should be maintained as to loan policies, and uniform methods of procedure should be installed. This will assist in eliminating losses due to unsound loan policies, which may originate at any unit and will give the member banks the advantage of the central organization and the benefit of the judgment and experience of the officers in the central organization. This will reflect in increased earning power for the corporation; however, in order to get more out of each member bank and each bank manager, considerable leeway should be allowed them as soon as it is shown that they have the ability. In order to get the best results the unit, so far as the public is concerned, should appear as a separate bank. That is, the borrowers and depositors should be made to feel that they are dealing with the individual bank and with an officer who has authority to take care of their requirements; they must not feel that they are merely dealing with a clerk representing the head office, located in some other city. The local manager should always take the responsibility of passing on the credit, so far as the customer is

concerned, even though he may have to pass it on to the head office for approval. In other words he should never "pass the buck" on a credit line to the head office. This will in the long run merely weaken his position in the eyes of the customer.

In order to get the full benefit from the member bank, a sound loan policy should be outlined by the head office in conjunction with the bank managers. Then the local bank should be organized to carry out this policy. That is, they should have proper managing personnel, together with an executive committee to advise with. The local board, of course, must be in harmony with the loan policies as adopted. The head office organization should always be ready and willing to consult with and advise the local management on any credit line which they may present; however, after the loan policy has once been formulated and loan limits have been determined by the managing officers, they should only refer to the head office when there is a question on the line, and should not attempt to lean on the head office too much. Dependence will not develop the local management nor will it make a strong member bank.

SELECTION OF THE LOCAL MANAGER

In selecting the local manager, there are of course many questions to be considered, but so far as possible a man should be selected who has enough ability to handle credits in that bank up to its legal loan limit. The management of the head office should be willing to pay sufficient salary to get that type of management for the member banks. The member

bank should then be given authority to make loans up to the legal loan limit, based on loan policies already set out and without referring them to the head office. Reports should, however, be made to the head office on all loan activity and a credit inspection by the head office should be made frequently enough to assure the head office that sound loan policies are being pursued. This will do away with much duplicate work at the head office and still give the benefit of group banking to the individual member bank and the community it serves.

It may be advisable and valuable to divide the member banks in the group into smaller groups, and select the manager of the larger bank in the group as a supervising manager of the other banks in that particular group. In other words the loan committees of the various banks of the group could be made up of the manager of the local bank, the manager of the larger bank in the group, and representatives of the boards of directors of the local banks. This gives the smaller unit the benefit of the advice and counsel of the manager of the larger bank in that particular group and acts as a safety valve for the holding corporation. It still does not take the responsibility for proper checking and follow-up from the head office. The above procedure would take care of the loan administration for the local bank covering loans up to its legal limit or up to the amounts already determined as the loan limit for the individual member bank.

In case of excess lines, the originating member bank should first act on the loan, and then complete credit information, together with the application and recommendations of the local committee, should be sent to the head

office for approval. If approved, it may be handled by the head office direct with the customer, or better, so far as possible, it should be handled with the borrower through the local member bank. A participation in the line up to the legal limit of the member bank should be carried by them and the balance sent to the head office to be placed by them with banks in the system which may have excess funds, always with the proviso that the receiving bank approve the credit. It is a good idea to concentrate excess funds from member banks in the system with one or two of the larger banks, and then the excess credit lines may be carried by these larger banks, rather than to split the excess portion over several banks in the group. Better control and supervision can thus be maintained.

The member banks in the system having excess funds should be allowed special interest on the excess funds carried by the larger banks in the group, so that they can benefit by the earnings on these excess funds. This interest rate to be paid on the excess funds may be determined by the average earning rate of the larger bank. Excess funds of member banks, however, are only funds which would be available for investment after the member bank has invested a proper percentage of its funds in bonds and other secondary reserve, as well as deducted the required reserve for the individual bank, even though this required reserve may be carried with the larger bank, which also receives excess deposits.

EXHIBIT "A"

Complete credit files should be maintained at the head office on all

EXHIBIT "B"

FIRST NATIONAL BANK

Ogden, Utah
No

To

Name of Selling Bank—

[illegible]

RECORD OF NOTES PURCHASED

FIRST NATIONAL BANK

Ogden, Utah No.

From

Name of Purchasing Bank—

[illegible]

excess credit lines, and the member bank originating the credit line should forward to the head office all information which it may receive at various times, pertaining to this credit line.

ing where the credit line is carried.

EXHIBIT "B"

A cross record should also be kept

EXHIBIT "D"

REPORT OF CHANGES IN LOANS SOLD

Date _____

Maker of Loan

Total line including all notes \$ _____.

New loan of \$ _____ made _____ dated _____ due _____

rate _____ %. Sold to _____
If carried by yourself so state

Loan of \$ _____ dated _____ due _____ rate _____ %.

Paid this date. Loan carried by _____.

Loan of \$ _____ dated _____ due _____ rate _____ %.

Renewal dated _____ due _____ rate _____ %. Carried by _____.

Loan of \$ _____ dated _____ due _____ rate _____ %.

Carried by _____ repurchased by this Bank.

Originating Bank

NOTE: This report to be mailed to G. S. Eccles, Secretary-Treasurer, First Security Corporation, Ogden, Utah, at any time there is a change in notes where part or all of line is carried by other Banks. Use reverse side for remarks.

A control record should be kept at head office under the name of the borrower, giving detail of all notes outstanding, as to amounts, rate, maturity, and security, and a list show-

under the name of the bank which would show in detail all credit lines originating through that bank so that it may be determined at all times what portion of the credits in the sys-

EXHIBIT "D" (cont.)
REPORT OF LOANS SOLD

193

By

As of

Bank			Date				
Name of Borrower	Amount of Note Sold	Amount of Note Carried by Us	Rate	Date of Note	Maturity of Note	To Whom Sold	Security

EXHIBIT "D" (cont.)
REPORT OF LOANS PURCHASED

193

By

As of

- Bank		Date				
Name of Borrower	Amount of Note	Rate	Date	Maturity	From Whom Purchased	Security

EXHIBIT "E"
REPORT OF CREDIT EXAMINATION OF

AT CLOSE OF BUSINESS	19
Examination Commenced at	M 19
Examination Finished at	M 19
Report Submitted by	

Assistant Vice-President—General Auditor

RESOURCES			
1. Due from Banks (Reserve)		31 Certified Checks	
2 Cash on Hand		32 Savings Deposits	
3 Clearing Items		33 Time, C.D.'s	
4 Cash Items		34. Trust Deposits	
5. Transit Items		35. Dividends Unpaid	
6 Deferment Items		36. _____	
7 U. S. & Readily Mkt. Bonds		Total Deposits:	
8. Warrants		37. Capital	
9 Call and Brokers' Loans		38 Surplus	
Total Cash Resources		39 Undivided Profits (Net)	
10 Loans and Discounts		40 Reserves: For	
11 Overdrafts		(a) Interest Accrued	
12. Other Securities		(b) Taxes	
13. Banking House or Stock Inv		(c) Depreciation F & F.	
14. Furniture and Fixtures		(d) Depreciation Bank House	
15. Other Real Estate Owned		(e) Depreciation Other Items	
16 Claims and Judgments		(f) Loss No 1	
17 Other Assets		(g) Loss No. 2	
18 Unexpired Insurance		(h) Contingencies	
19. Bond Interest Accrued		(j) Dividends	
20. Expenses in Excess of Earnings		(k) _____	
21. Cash Short		Total Capitalization:	
22. Trust Department		_____	
23 Interest Earned Not Collected		41. Bonds Sold Repurchase	
24 _____		42. Bills Payable	
25. _____		43. Rediscounts	
Total Resources		44. Reserve Overdrafts	
LIABILITIES		45. Cash Over	
26. Due to Banks		46. Trust Department	
27. Public Funds Inc. Postal Savings		47. Reserve for Uncollected Interest	
28. Individual Deposits		48. _____	
29. Demand C.D.'s.		49. Total Liabilities	
30. Cashier's Checks			

EXHIBIT "E" (cont.)
SCHEDULE 46—DIRECTORS AND EMPLOYEES

[illegible]

Is authorization shown covering loans to Directors, Officers, and Employees?_____

No. of Shares Owned	Name	P. O. Address	Lia. as Payer Ind. and Firm Inc. Overdrafts	Lia. as Endorser or Guarantor	Occupation
		TOTAL			

EXHIBIT "E" (cont.)
RECAPITULATION OF BOND ACCOUNT

Total Par Value of Bonds	\$ _____
Total Book Value of Bonds	\$ _____
Total Market Value of Bonds	\$ _____
Profit	\$ _____
Loss	\$ _____
Average Investment Earning Rate	_____ %

IRREGULAR AND QUESTIONABLE
CASH ITEMS

List Name	Amount	Remarks

LINES OF CREDIT GRANTED THROUGH TRANSIT ACCOUNT

Name	Amount This Date	Amt. of Commit- ment	Remarks

a detailed report to head office covering each note which may be executed so that head office can keep the above records on file. When the notes fall due they may be sent for collection direct to the originating bank, and payment may be made direct to the bank which participates in the line without going through head office; however, when this is done a complete report by the originating bank covering all payments should be sent to the head office for the purpose of the above records. In case a line is renewed, the note also may

Another record should be kept under the name of the bank, showing a detail of all excess credits, which the bank is participating in. This would cover notes purchased by it. This

may be termed Exhibit "C." A recap of these two cards should always balance. This total should also equal the total of the record of excess loans carried in the system.

In case all excess lines are not being handled directly through the head office, but are merely approved by it and then placed with a member bank designated by it, the bank originating the credit line should send

If demand for credit is excessive upon a member bank and if other banks in the system have surplus funds, the member bank may build up its reserve position by selling its paper without recourse to other banks in the system. This paper should be accepted by the receiving bank upon its merits; it should have full right of rejection. In case the paper

EXHIBIT "E" (cont.)

WARRANTS

Describe Any Irregular or Questionable Warrants

RECAPITULATION OF LOANS

	Total Loans		\$ _____
	Good	\$ _____	
	Slow	\$ _____	
	Doubtful	\$ _____	
	Loss	\$ _____	\$ _____
FARMERS			
_____	Secured	\$ _____	
_____	Unsecured	\$ _____	
_____	Endorsed	\$ _____	\$ _____
LOCAL BUSINESS			
_____	Secured	\$ _____	
_____	Unsecured	\$ _____	
_____	Endorsed	\$ _____	\$ _____
LIVESTOCK			
_____	Secured Sheep	\$ _____	
_____	Unsecured Sheep	\$ _____	
_____	Endorsed Sheep	\$ _____	\$ _____
_____	Secured Cattle	\$ _____	
_____	Unsecured Cattle	\$ _____	
_____	Endorsed Cattle	\$ _____	\$ _____
_____	Secured Dairy and Hogs	\$ _____	
_____	Unsecured Dairy and Hogs	\$ _____	
_____	Endorsed Dairy and Hogs	\$ _____	\$ _____
INDIVIDUAL			
_____	Secured	\$ _____	
_____	Unsecured	\$ _____	
_____	Endorsed	\$ _____	\$ _____
AUTO AND RADIO			
_____	Secured	\$ _____	
_____	Unsecured	\$ _____	
_____	Endorsed	\$ _____	\$ _____
SECURED REAL ESTATE			
_____	Secured _____		\$ _____
_____	Unsecured _____		\$ _____
_____	Endorsed _____		\$ _____
TOTAL NO. LOANS _____			TOTAL \$ _____

MISCELLANEOUS

should be approved by it and future loss should develop, it should absorb this loss. These notes may be handled in the same manner as the excess credit lines, so far as placing them with the banks is concerned. That is, it is not necessary for these particular notes to be sent through the head office; however, head office should approve of the amount which the member bank desires to sell and designate which bank the paper should be sold to. Complete information covering these particular notes should be sent in to head office in

that member bank, and will also show the amount of credit other banks in the system are carrying for the benefit of each of the other member banks. These details give the head office proper information, so that it may determine whether too much credit is being extended in any particular territory. Head office also gets full information covering loans passing between the member banks. It is also able to tell at all times whether loans are being paid at maturity or properly renewed, or whether the paper is allowed to become past due.

EXHIBIT "E" (cont.)
CLASSIFICATION OF LOANS AND DISCOUNTS

Borrower	Amount	Criticized	Slow	Doubtful	Loss

the same manner as the information sent in on excess lines, so that the record of notes sold would include excess lines sold, as well as other lines which may be sold to build up their reserve position, and the record of lines purchased would also include all notes, whether excess lines or lines sold to build up the bank's cash position.

A recap of these records at any time would show the total amount of credit originating through any member bank, which is not being carried by

It gives a very good check by head office of the member banks; however, this check is not sufficient and there should be periodic credit inspections made by the credit department of the head office.

EXHIBIT "E"

The credit examination report follows: balance sheet of the bank as of the date of the examination; schedule of loans to directors and employees; schedule of loans to com-

EXHIBIT "E" (cont.)

RATE

AMOUNT

_____ %	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____

Average Earning Rate _____ %

(Note—See Rate Balance Sheet)

WARRANTS

Describe Any Irregular or Questionable Warrants _____

EXCESS LOANS

Name	Amount	Remarks
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

OBLIGATION OF OFFICERS, DIRECTORS AND CORPORATION
IN WHICH INTERESTED

Borrower	Officer or Director Interested	Amount
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

EXHIBIT "E" (cont.)
STATUTORY BAD DEBTS

Borrower	Maturity	Amount	Remarks

OVERDRAFTS
IRREGULAR, DOUBTFUL OR LOSS ITEMS

Name	Date Incurred	Amount	Remarks

OTHER SECURITIES

Items and Description	Book Value	Remarks

BANKING HOUSE FURNITURE AND FIXTURES

Bank House	Book Value Less Depreciation	\$ _____
Furniture and Fixtures	Book Value Less Depreciation	\$ _____

REMARKS: (General, including new equipment, repairs, alterations, etc.: also adequate insurance.)

EXHIBIT "E" (cont.)
OTHER REAL ESTATE

Description	Book Value	Prior	Market	Remarks

RECAPITULATION

Item	Amount	Slow	Doubtful	Loss

CLAIMS AND JUDGMENTS

Description	Amount	Remarks

RECAPITULATION

Item	Amount	Slow	Doubtful	Loss

RECAPITULATION OF ASSETS

	Amount	Liquid	Slow	Doubtful	Loss
Cash and Due from Banks					
Bonds and Warrants					
Cash Items					
Loans and Discounts					
Overdrafts					
Bank House Furn. & Fix. (Net)					
Other Real Estate					
Claims and Judgments					
Unexpired Insurance					
Accrued Interest Bonds					
TOTAL					

EXHIBIT "E" (cont.)
GENERAL RECAPITULATION

	Amount	Liquid	Slow	Doubtful	Loss
TOTAL ASSETS					

Deposit Liability \$ _____

Accrued Interest and Tax Liability _____

Total \$ _____

Capital \$ _____

Surplus _____

Profits _____

Res. for Loss _____

Res. for Conting'cy, etc. _____

_____ \$ _____

Total Liability \$ _____

CHARGED OFF ASSETS

Possible Salvage \$ _____

Doubtful Salvage _____

Total Loss No Salvage _____

Total \$ _____

REMARKS

the credit department of holding company, and the management of the holding corporation should see to it that the earnings of the member banks are properly conserved, so that sufficient reserves are carried at all times to take care of the assets which may be classified by the examining department as doubtful or loss. If sufficient earnings are not available to set up this reserve, it is the duty of the holding corporation to see that sufficient funds are put into the bank by the corporation to enable it to set up satisfactory reserves. It is only by this procedure that the liquidity of each member bank can properly be conserved, and with each bank in the system in a satisfactory liquid condition, the corporation as a whole will be in a sound financial condition.

You can readily see that if group banking is to be of any advantage, proper supervision should be had at all times over the various member banks of the group, and in order to do this it is necessary that proper credit information, proper credit inspection reports, and proper follow-up systems be had by the head office at all times. Each member bank should be a strong unit within itself, not only considering its assets, but it should be a strong individual unit from the standpoint of its managing personnel, with the holding corporation or head office an added factor to strengthen the individual unit.

Discussion

FRED C. SCHMOCKER (Federal Reserve Bank, Oklahoma City): How are the credit policies passed on to the new unit which may become affiliated with the group?

MR. ECCLES: A group banking

system is usually a system that has grown up by acquiring new units at various times; that is, by adding to the system, increasing its size and the number of its units. The question was, "How are these credit policies passed on to the new units which may be acquired by the holding corporation?"

These credit policies are not written. They are nothing defined by rule of thumb. Whenever a new unit is taken into the group, you can, of course, realize how important it is for the management of the group to make a thorough checking of the unit. This is usually accomplished by the executive committee, or the examining committee, or the credit committee, or whatever committee the holding corporation may have going into the unit. They are going to talk over and check over the paper of that particular unit with the management.

They make detailed classification of the credit lines and go over each credit line in detail with the management, checking over the credit files. In doing that it is pretty easy to appraise the ability of the manager of that particular unit. You can determine at that time usually whether or not you have a man in that particular unit able to take on the management of the unit after it becomes part of the group.

If that is the case, then you take that particular man and he is the one with whom you deal when you are making a thorough checking of the bank. If you are checking over every credit line with him, if you are criticizing it from your standpoint, if you are asking for certain credit information which he might not have and which you require, all this shows

your attitude on credit policy. If he is the right type of man, he can very readily determine what the policy should be regarding credit.

After the unit becomes part of the group, you have to give very close checking to that particular unit until the manager of it becomes familiar with your policy. That is the only method to use. Of course, different questions come up all the time, and this manager can readily formulate your policies. Then, by your proper follow-up and proper checking, you can very readily set him straight.

outlined, it is left up to the management to follow its own initiative in carrying out those policies.

In other words, if we state that we are going to loan on live stock, or we are going to loan to merchants, or whatever it may be, this individual manager has full leeway in carrying out the policies. It is up to him to show his ability in doing so. It gives him a lot of room for his individual initiative.

HOWARD RITTER (Security Trust & Savings Bank, San Diego): By having a central management con-

BANK					EXHIBIT	
Borrower	Past Due	Amount	Remarks	Secured	Farmer	Merchant

DEWEY ARDOIN (Calcasieu National Bank, Lake Charles, Louisiana): Is the formulation of credit policies by the central management of a bank or group organization detrimental to individual initiative?

MR. ECCLES: Personally, I don't think it is, because the policies are not definite. They are not a rule of thumb. There are general credit policies as to the types of credit taken on, but individual credit lines are not outlined, except for the legal loan limit. After the credit policies are

trol the credit policy, would not the peculiar credit needs of any particular community probably be overlooked?

MR. ECCLES: In answering that question, let me say that the credit policy is not formulated by the head office alone. That is, it should be formulated by the head office through meetings with the various units in the system. The manager or management of the local unit has a good deal of authority, has a chance to express his credit views; and it is

through the credit views of the various local managers that the general credit policy is formulated. When that policy is formulated it leaves so much leeway with the local management that I hardly see how the policy set forth by the general organization can have any detrimental effect upon any particular credit line, or how the needs of the community, if they are sound, can be overlooked. If there was a need of the community which should be taken care of by a loan company or a building and loan company or anything of that sort, the

MR. ECCLES: In reply to the questionnaire I submitted to the various groups, in no instance do they say that the loss has actually been absorbed by the originating bank, but in one case it was stated that if a loss developed it was their opinion that it should be absorbed by the originating bank. In another case, they said that they felt that, because the credit line had been approved by the participating bank, that bank should absorb a loss if it developed. Still another unit system said that it had not developed any losses in its

E" (cont.)

Date _____ No. _____

CLASSIFICATION						ITEMS FOR ATTENTION			
Livestock		Individual	Auto-mobile	Real Estate	Miscellaneous	Criticized	Slow	Doubtful	Loss
Sheep	Cattle								

head office probably would not approve that particular type of credit.

GEORGE R. HERZOG (The Union Trust Company, Cleveland): There are two things on my mind. The first may be just a misunderstanding. Did I understand you to say that in some instances losses on excess loans are borne by the first member bank of the group? In other words, those losses are not borne by the member bank carrying the excess loan—the bank originating the loan?

excess lines, so the question had not arisen.

Personally, I think that the originating bank should not subrogate, and that it should not try to absorb any loss which originates in excess lines, other than in the portion of the line which it might be carrying. That acts as a second safety valve on the approving of excess credit. That is, the originating bank passes on it; the head office passes on it; and the bank receiving or participating in the credit line passes on it;

so if there is any advantage in passing on credits, in getting different viewpoints and different ideas, I think we have it in this particular case.

MR. HERZOG: Won't your examiner object to having your first member of the unit carry it?

MR. ECCLES: In no case do they think that the originating bank should absorb the excess loss. The thought there was that the originating bank, if it does absorb any loss, would subrogate its portion of the line to the portion which is carried by the other member banks. That is, if you have a line of credit of \$200,000 and the originating bank has a legal loan limit of \$50,000, the other \$150,000 of that is placed with other member banks.

If a loss should develop on that line and the loss was \$50,000, that is, the legal limit and the amount carried by the originating bank, some say that bank should absorb the loss. If the loss is larger than \$50,000, if it is \$100,000, then they feel the originating bank should first absorb \$50,000 and the balance be prorated between the other participating banks.

That has not arisen in our particular group and I don't know what the attitude would be on it, but on any credit line that originates a member bank may subrogate its portion. If

it develops that a part does go bad it looks to me that the banks participating in it should absorb the loss, based on the proportion of the line they are carrying.

EDWIN V. KRICK (American Trust Company, San Francisco): In your investigations have you run across any information on the attitude of the state banking departments or Federal Reserve examiners on the allocation of losses on excess lines?

MR. ECCLES: I might say on that, I am fortunate in the fact that I have the general auditor in charge of the credit examinations of our particular system in the audience today, and I am going to ask him to answer that question.—Mr. Canfield.

CHARLES I. CANFIELD (First Security Corporation System, Ogden): Not the Federal Reserve examiners, but the national and state examiners with whom I have discussed that particular phase, view it entirely from the standpoint of the desirability of the credit extended. They feel that if the line is in the condition it has to be subrogated, it is not a fit obligation.

As a consequence they tell me that it would be their idea to require the elimination of that line, or at least have sufficient reserve placed in the reserve account to take care of possible loss.

Financing Agricultural and Live Stock Credits

By GEORGE B. HARRISON

PRESIDENT OF THE DENVER NATIONAL BANK, DENVER, COLORADO

Address before the Denver Departmental Conference

Mr. Harrison discusses the basic importance of the agriculture and live stock industries. After presenting the factors operating toward lack of organization in these industries, he offers five suggestions which would work toward their stabilization:

1. The farmer must be impressed with the fact that his is a business, and that up to date business methods must be adopted.
2. He must be convinced that he cannot live to himself, but must sincerely cooperate with others in his industry; in other words, his salvation is in organization.
3. He must be convinced that only through organization can production be controlled and orderly marketing effected.
4. He must be convinced that through production control and orderly marketing only can price stabilization be effected.
5. He must be taught the necessity of keeping a sufficient margin of liquid or quick assets to meet unexpected emergencies.

AGRICULTURE and live stock are so closely allied, each so dependent on the other, that it is proper and necessary to consider them as one activity, and to include both, as one, in our discussion. In fact, much of our grain, and most of our hay product, is marketed through live stock, and except in the "range" country we find that each operator is more or less involved in both undertakings.

Our subject is of such tremendous importance, covers such a broad field, and has so many involved problems, I know you realize we cannot do more than touch the high spots in the time allotted to me. I must admit that in my attempt to be brief, I have had difficulty in deciding just where and

how to begin this preliminary discussion, and where and how to end it. In my judgment it will be best to present the subject in a general way and not attempt to be specific. In any event, let us hope that what will be said will result in serious thought here and hereafter on the part of those present; that this organization will lend its aid in the solving of the problems involved, and in stabilizing these industries on a prosperous basis.

First and foremost we must realize the importance of these industries. Ever bear in mind that they are the oldest known to man, that they are basic, that in them are involved the production of those raw materials, our food supply, on which life itself primarily depends. Every human en-

deavor, no matter what or how necessary we feel it is, rests primarily on our food supply. The importance and necessity of the agricultural and live stock industries is therefore obvious.

THE EXTENT OF OUR DEPENDENCE ON THESE INDUSTRIES

Now let us approach the subject from another angle, and consider briefly to what extent our general prosperity is dependent on these industries. Realizing that there are some duplications in arriving at the estimates. I find from Government reports that in 1929 the total farm value of sixty-seven principal crops reached the stupendous sum of \$8,664,000,000; and that the value of our cattle, sheep, and hog production was \$4,583,000,000, or a total of almost thirteen and a quarter billion dollars. I would ask you here to bear in mind that we are considering industries that are producing raw materials only.

It is estimated that, after allowing for operating expenses, interest, taxes, home consumption, and so forth, the primary buying power of those engaged in these industries is fully \$1,000,000,000 annually, and possibly \$1,250,000,000. I say "primary buying power" because those who furnish the labor on the farms, and those who receive interest on farm loans also derive a buying power from these activities.

Let us proceed a step further! In processing or fabricating these raw materials for human use, do not fail to take into account the labor that is employed. It would be well to consider also the labor that is employed to manufacture the equipment that is used in this processing; and in addi-

tion, the labor that is used to furnish the raw material out of which the equipment is made. And then consider the enormous buying power thus created.

To illustrate, let us try to visualize the importance in our economic structure of our cotton and woolen mills, our meat packing plants, our fruit packing plants, our flour milling plants, and many others, almost ad infinitum, all of which come from processing the raw materials which the farmer and live stock men produce.

I have not had the time or the opportunity to get proper data to make a definite statement, but I will hazard the guess that fully 50%, and possibly 60%, of the economic activity of our country is dependent upon the agriculture and live stock production of raw materials, their processing and their transportation. I do not think we have the time, nor is it necessary, to proceed further with this analysis. It can hardly be questioned that the purchasing power of the nation is largely predicated upon its soil and live stock production.

With the natural growth and development of our country, the older sections have become more and more industrialized, and agriculture and live stock have become the major activities of the newer sections. As a result, to speak of it geographically, the East, and the industrial centers of the West, have naturally, and I feel thoughtlessly, permitted themselves to become so engrossed in their own immediate economic problems and welfare, that they have overlooked many fundamentals on which their prosperity depends, forgetting that their prosperity depends largely on the ability of others to buy their products.

Admitting the importance of indus-

tries producing luxuries, and those necessities which but yesterday were luxuries, I am satisfied we will all finally conclude that our agriculture and live stock interests are of such vital importance that they not only should, but must, be stabilized, so far as possible, on a prosperous basis.

But notwithstanding the enormous value of its products, notwithstanding the necessity of these products to our welfare, farming, over any given series of years, has not been profitable. This is evidenced by, and is the reason for, so many of our young men and women leaving the farm to enter industrial life. Such competency as has come to the farmer is more the result of the increase in the value of his land than of profits from his business. There are several reasons for this result, and it might be well to consider some of them.

FACTORS IN LACK OF ORGANIZATION

When we realize the importance of these industries, it might seem strange that they have not been better organized and the factors involved not under better control. There are three major reasons for these conditions:

1. The great number and small size of the units of production, each independently owned and independently operated: what is commonly termed "big business" has never been attracted to agriculture and live stock, with the result that we find no consolidation of the small units into larger ones.

2. Diversified production: many different crops, the aggregate of the totals of each being large, and each requiring specific control.

3. The fact that every farmer is an individualist: up to this time he has never been convinced of the value of cooperation.

Numerous attempts have been made to put these important industries on a better basis. But they were of a more or less temporary nature; they were intended as temporary relief, and were not always wisely conceived.

To meet existing emergencies we have had our live stock finance corporations, our stockgrowers' finance corporations, our war finance corporations, our Intermediate Credit banks, our Joint Stock Land banks, our Federal Land banks, and what not. Many of these, through their operations, resulted in overexpansion and overproduction. Readjustment of these conditions has brought serious grief. All were instruments of credit, and so far as current needs are concerned, I am convinced the farmer has suffered more from too much credit, than from too little.

We now have among us, as the result largely of political expediency, the Federal Farm Board. It is too early yet to commend or criticize its efforts, too early yet to say what the results will be.

COOPERATIVE MARKETING

If policies as reported are final, I fear their wisdom. Economic law cannot be eliminated or controlled by statute. I believe firmly in cooperative marketing as a panacea for the farmer's ills; but in my judgment, with the possible exception of a limited reserve of credit to protect temporarily a small territory lacking proper bank facilities, the cooperative movement should limit its activities to an orderly marketing of the produce it is organized to control. In no event, in my judgment, with the exception mentioned, should these activities extend to financing, and never should

they attempt unduly to control, market prices. The law of supply and demand always has been, and always will be, supreme.

There are elements of hazard in farming (and I include in farming, agriculture, horticulture, and live stock) which are inherent and cannot be eliminated. Production cannot be controlled as efficiently as in other lines of industry. Climatic conditions, which are such important factors in production, cannot be foretold months in advance. Our winter wheat is planted in the early fall, and harvested in the midsummer following. Other crops are planted in the spring and harvested in the fall. Who can foretell the effects of possible excessive cold, of extreme heat, of drought, of excessive moisture, of cyclones and lesser storms? All of these affect production and the hazards cannot be eliminated.

Increased acreage does not necessarily mean increased production; and decreased acreage does not necessarily mean decreased production. When you enter the field of horticulture, you have an added problem; whether it is apples, or peaches, or citrous fruit, it takes several years to mature an orchard or grove, and one cannot destroy or replace his trees from year to year. However, these hazards are counterbalanced by the fact that food never goes out of style, and there is a constant demand for food products.

In any attempt to better the farmer's condition, to stabilize the agricultural and live stock industry, I wish to repeat that we must ever bear in mind that he is a producer of raw materials, materials that are basically necessary to every human being, and that any adjustment of prices upward enters vitally into the cost of living.

The increase in the cost of living is the bugaboo that is ever met when an attempt is made to better the condition of the farmer. Any suggestion of a means to increase the market value of farm products is always opposed on the ground that it will increase the cost of living, with the result that we have never had, until recently, any solution of the farm problem proposed except additional credit facilities. As I have indicated before, in my judgment, additional credit is not the cure.

Neither is increased production the cure. In fact, through improved machinery, intelligent fertilization, and better management, farming today is suffering from too much production. It follows, therefore, that the problem of farm operating cost cannot be solved by increased production, for increased production will simply decrease market value.

For many years we have been striving to raise our standard of living, and rightly so. Tariffs have been provided by statute, and many other means adopted to enable our industrial world to increase wages to labor. But that effort has stopped at industrial labor. Farm labor is as much entitled to a reasonable return, a return that will enable the farm worker to enjoy a high standard of living similar to that of industrial labor. That cannot be accomplished until farming is put on a fairly prosperous basis. What is the solution? That is the problem of the nation today.

SUGGESTIONS FOR STABILIZATION

The necessities and rights of the consumer (and you and I belong to that class) cannot be overlooked. Let me hazard a few suggestions:

1. The farmer must be impressed with the fact that his is a business, and that up to date business methods must be adopted.

2. He must be convinced that he cannot live to himself, but must sincerely cooperate with others in his industry; in other words, his salvation is in organization.

3. He must be convinced that only through organization can production be controlled and orderly marketing effected.

4. He must be convinced that through production control and orderly marketing only can price stabilization be effected.

5. He must be taught the necessity of keeping a sufficient margin of liquid or quick assets to meet unexpected emergencies.

Possibly, other suggestions of great value will occur to you, but I feel if these I have mentioned can be put into effect, the agricultural and live stock industries will be stabilized, and their credits placed on a sound and satisfactory basis.

Discussion

EUGENE McELVANEY (First National Bank, Dallas): To what extent do you think that control of the situation lies in the hands of the country banker himself? I don't know what your situation is in Colorado, but the average tenant farmer in Texas depends a great deal upon bank credit to make his crop. It occurs to me that the control of the situation lies largely in the hands of the country banker who extends the credit. If he holds the string and has the say as to how that money shall be expended and how the farmer shall conduct his operations, it seems to me we have a pretty good solution right there.

MR. HARRISON: I think you are

correct in that. What I have attempted to do in this short paper is to get the bankers interested in the solution of this problem. I haven't attempted to be specific in it; I thought it unwise to be so. It must be handled, rather, along educational lines. The individual bank should use its efforts to keep its farming customers within safe limits—not to extend credit where credit is not deserved.

Some of the best minds in America are interested in solving the farm problem. Every bank can do a certain amount of education with a view to getting its clientele to cooperate. In the future, the working out of these problems is up to you gentlemen. It is worthy of your serious thought. You should assist farmers as well as you can, but it is more important to study the fundamentals involved in working out the whole problem.

ALFRED E. ROBERTS (Calcasieu National Bank, Lake Charles, Louisiana): May I ask a question which is almost a duplication of Mr. McElvaney's? He brought out the need of impressing the farmer with the fact that he must conduct his industry along business lines. Is it not also essential that the country banks require their customers to know what their total income is, and what their operating costs are?

MR. HARRISON: I think so, without question. In my banking experience I have always reserved the right myself to dictate to my customers how their business shall be handled, and it is up to every other bank to do the same thing, in my judgment. Of course, a great many of our credits are absolutely safe. We don't have to take any action. The man operating the business is just

as good a man as I am. If a man's business doesn't measure up to my requirements, I get rid of it.

I was brought up down in Missouri, where we have no hazard from hail, for instance; but every shock of wheat was capped, and I have capped many myself when I was somewhat younger than I am today. If you go to northern Colorado, where there is a serious hail hazard, you won't find one field of wheat in twenty-five capped. In other words, the hazard of hail is still there after

the wheat is cut and put in the shock. I have told the bankers of Colorado that I would not loan a dollar to a farmer who would not cap his wheat and save it from the hail risk.

I think the bankers have to be, in certain cases, a little more strict in defining the policies of their clientele; I think it is their right. There are hazards involved here which have to be corrected as nearly as possible, and there is no reason in the world that I can see why a bank should assume any undue risk.

Reciprocal Relations Involving the Credit Department of a Commercial Bank

By E. L. BLAINE, JR.

CASHIER OF THE PEOPLES FIRST AVENUE BANK, SEATTLE, WASHINGTON
Address before the Denver Departmental Conference

Mr. Blaine assigns to the credit department six major tasks:

1. Creation of a complete central file card on every customer of the bank
2. Development and maintenance of a complete credit file on every borrower
3. Creation and maintenance of an industrial classification file on all loans
4. Maintenance of a current file on all lines of credit
5. Development and maintenance of a rediscount file
6. Maintenance of a record of all available information on non-customers.

Mr. Blaine urges the granting of authority to this department in return for the assistance it is rendering throughout the bank.

THE importance of the subject assigned for discussion at this time varies in the case of each bank represented here in direct proportion to the size of the institution. There is little of interest in it for the smaller banks, since they do not maintain a separate credit department, but as you begin to segregate the work of investigating and recording the credit from that of approving the loan, the problem begins to appear. When you finally establish a distinct and separate department for this work, the correct solution of its relation to other departments becomes of vital importance to the efficiency of your whole organization.

To get the greatest value from our

study, we should consider the subject in its most complicated form. For the sake of this paper, therefore, we will assume that we are analyzing the problem as it arises in the larger modern banks.

The credit department of such an institution occupies a rather difficult position. It is one of the few departments which is unable to point to any specific income items in the bank's earning statement as a justification for the expense which is charged against it. We should find it worth while, therefore, to analyze this division of the institution and see whether it can justify its place in the organization; to study it, not separately, but in its relation to the whole.

WHAT A CREDIT DEPARTMENT SHOULD BE

In starting out on our investigation, let us first draw a picture of what this credit department is or should be. There are many ideas on the subject. Probably no two such departments in the entire country would be found to be identical in their duties, in their authority, or in the scope of their responsibility. Therefore, the obligations and rights of the department which is outlined here should not be taken as complete or above criticism. Some of the ideas are mentioned as a result of witnessing their successful application in one or more banks. Others are to a degree the product of a fertile imagination. Naturally, it would not be practical to apply this theoretical set-up in its entirety to any particular bank, since the internal organization of the institution or the ability of the present personnel must govern the actual application of any plan of procedure. We must, however, erect some more or less definite structure as a basis for study and assign to it certain duties, responsibilities, and authority. It is to be hoped that the discussion scheduled to follow this paper will bring out any merit or lack of merit in what is here set forth.

SIX MAJOR TASKS OF THE CREDIT DEPARTMENT

Our credit department is going to have only six major tasks. This does not seem like a large order, but as we review the work necessary to these six, I believe you will agree that we have assigned a sufficient number of duties to keep it busy. There are innumerable small tasks, many of

which are important in themselves, coincident with each major one, but the six steps outlined here, when efficiently performed, will prove the existence of a capable and valuable credit department.

1. Creation of a complete central file card on every customer of the bank
2. Development and maintenance of a complete credit file on every borrower
3. Creation and maintenance of an industrial classification file on all loans
4. Maintenance of a current file on all lines of credit
5. Development and maintenance of a rediscount file
6. Maintenance of a record of all available information on non-customers.

If we take these tasks one by one and study the methods used in accomplishing each, we shall have an excellent picture of this phase of bank work. We shall also discover many unnoticed or unknown relations existing between the credit department and the officers and other departments.

CENTRAL FILE CARDS

Take first the central file cards. These should contain in as condensed form as possible every item of valuable information regarding or affecting any relation existing between the customer and the bank. No definite rule can be laid down, but they should include in essence the following items:

1. Customer's name, address, and business connection
2. A list of all the departments of the bank with which he transacts business

3. A record of balances maintained and of "not sufficient funds" checks or overdrafts
4. A list of references and a brief notation as to their recommendation or criticism.

In many banks the maintenance of these cards is the special task of the statistical department. That is why I assigned only the creation of the file to the credit department. The appointment of persons who may have charge of seeing that the necessary entries are made is a matter of internal organization, but the ultimate authority over central file information should rest in the credit department and its consulting officers. No one knows better than they the type of information desired. Due heed must be given to the needs of other departments for space in this file, but the primary purpose behind its creation was the compilation of a customer history to serve as a basis for credit analysis. This file is the very foundation of credit work, and in banks where little in the way of complete files is maintained, some semblance of the records embodied in the central file will usually be found serving in their stead. This does not mean that they are recommended as a substitute for the complete credit file, although they can often serve in an emergency as a review of the customer's right to consideration.

If we look closely, we shall find in this first of the main activities of the credit department a number of ways in which its work ties in with and aids the work of others. From this record the commercial department is in a position to judge intelligently the depositor's rights in such matters as overdrafts and exchange charges. Likewise, from the checking of ref-

erences some indication or warning of what to expect from the account is obtained for the guidance of the tellers. Those on the watch for new accounts frequently find the notations as to the firm connections of individual customers of help in the solicitation of company accounts. Some have suggested the use of the records of average balances as a clue to prospects for the security department. The ethics of this practice will undoubtedly be questioned in a number of banks. Without doubt there is some danger. Still, in our present age, we have a widely diversified security buying public, and it is not unusual to see house to house security selling campaigns. Under these conditions there may be merit in the argument that it would be better for the bank's own security department to approach these clients than to see them taken in by some curbstone purveyor of wildcats. At least there is the potential value from the file in this connection, and if discretion and moderation are used, the procedure may result in mutual advantage to customer and to bank. Surely, no one will question the ethics or desirability of permitting the safe deposit, safekeeping, and trust departments to obtain from this source the record of security customers who might also become good prospects for their respective services. These are but a few of the reciprocal uses to which central file cards can be put.

COMPLETE CREDIT FILES ON BORROWING ACCOUNTS

The second and most important task of the credit personnel is the development and maintenance of the complete credit files on borrowing ac-

counts. These vary slightly with every bank, but in general all contain the following parts, which, after listing, we can analyze individually:

1. Financial statements and comparative analysis
2. Customer's loan arrangements and record
3. History of the account
4. Trade survey.

Most of us are familiar with the financial statement form which is more or less standard throughout the country. Obtaining these periodically from the customer requires a fine degree of cooperation from the officers. The task is essentially for the department, and the responsibility for missing statements is usually theirs. In many cases, however, the officer handling the account can obtain this information more easily and graciously than it can be done by means of a departmental form letter. The correct coordination of the two efforts is necessary to facilitate the gathering of these essential data and to do it with the minimum of friction with the customers. In the isolated case in which the borrower refuses this information, the situation should be brought to the personal attention of the executive handling the account. If for any reason the executive consents to this attitude, he should place a memorandum in the file, setting forth the customer's reasons and the justification for continuing the accommodation in the face of this violation of the general rule. This relieves the department from further responsibility.

The second part of the file is usually a form evolved by the department whereon can be shown the loan arrangements. This includes lines of credit, rate, and collateral require-

ments. Here also appears the past record of the loan, showing maximum and minimum amounts owing per month, usually divided into secured, unsecured, and discounts. In some banks the average balances of the commercial account are set up alongside these loan figures. In others, these balances are confined to the central file. It is a growing practice to show somewhere the net as well as the ledger average balances, and, in one case I know of, the average monthly amount of the loan is computed, so as to check intelligently the ratio between account and borrowings. On this same form space is provided for listing "not sufficient funds" checks and overdrafts. Likewise, the statistical department can post the results of the analysis of the commercial account from a profit and loss standpoint. Here, then, would be all of the information needed to show whether the customer deserves the accommodation he is getting, to show whether the account is worth while.

THE HISTORY SHEET

Next comes the history sheet. It starts out with an initial write-up by the one who investigated the first application from the customer. This should review briefly the experience with or knowledge of the account up to the time of the first credit dealings, should describe the history of the business and its prospects, should outline the accommodations needed, and should make a recommendation based upon the results of the investigation. Follow this by the decision of either the officer handling the account or the loan committee and you have all the original conditions and agreements of

your loan recorded. If every one subsequently handling the account will make notations of his arrangements with the customer, a brief review will enable any one to become familiar with the conditions of the loan from its inception up to the present time. With such a file a strange officer can serve the customer almost as efficiently and intelligently as the one who habitually handles the account. This sheet should be used as a place to record each bit of new general information coming to the attention of the bank. The avoidance of delay in serving depositors or borrowers is a goal we are all striving for. This can be accomplished without sacrificing intelligent treatment, even in cases of emergency, when such a record as we are describing is available.

To obtain the desired results of a complete history, the cooperation of the officers in making the notations is imperative, especially on small loans which do not receive committee action and would not, therefore, be otherwise written up.

TRADE AND BANK CHECKINGS

The fourth part of the file, the trade and bank checkings, is largely routine departmental work, but care must be exercised not to offend a customer by improper checking. The replies to inquiries should be carefully scrutinized to detect any hidden warnings, since in many cases the writer does not care openly to criticize the subject. A capable credit man can save the officers much time by analyzing these trade and bank checking letters and reducing the information of value therein to a short, condensed report. Otherwise, the officers must

read each letter with considerable waste of time, as much that is contained is either already known or is purely complementary. Nothing here is meant to reflect on the value of the customary reply to credit inquiries. The point to be made, however, is that the busy executive is really trying only to ferret out any new word of warning. If every report is entirely favorable, he is pleased with this confirmation of his own judgment, but he does not need to devote time to studying such replies.

The credit file was designed for but one purpose. For this reason its scope of usefulness is largely limited to the loaning officers. In some banks, however, the occasion has been found even here to create additional service. Many individual statement forms now ask whether the borrower has made a will. This has been utilized by the trust department as a source of valuable future business.

With the completion of this file the major work of many credit departments is finished. You will recall, however, that it was but the second of six tasks outlined earlier in this paper.

THE INDUSTRIAL CLASSIFICATION FILE

The third was the industrial classification file. In a bank such as we are studying, it is extremely easy to lose track of the amount of loanable funds being employed by each class of the bank's customers. A file is therefore created, showing the names of the borrowers and the amounts owing, classified by activity; such as retailers, wholesalers, jobbers, investment brokers, manufacturers, and so forth. These can be further subdivided, for

example, as in the case of finance companies into automobile, radio, furniture, and salary loan. When reports indicate that general conditions in a given line are unfavorable, the loan committee can tell at a glance the names of their borrowers who need watching. Frequently, such a file is a revelation to the executive committee as indicating a tendency to concentrate too much money in loans to certain industries, and corrections can be made. As in so many activities of the credit department this can be enlarged to serve others. It may easily be expanded to include all of the bank's customers and will then serve several other purposes. For example, the new business department would here have a complete list of the bank's present friends in any line who might be used to assist in soliciting a certain account. In the same way it could easily find what customers would probably be buying from the prospect, and through some of them could bring influence to bear. The bank's purchasing agent can use this record to determine the names of all customers who can supply certain merchandise or service, thus avoiding the tendency to patronize a select few. As a matter of fact, the credit department itself can obtain help from this enlarged file. In checking on applications for credit, it is often desirable to have some friend in the same business to answer certain general questions. From this industry file a wide assortment of names would be available.

CURRENT FILE ON ALL LINES OF CREDIT

An extremely important factor in the size of bank earnings is the effi-

cient handling of primary and secondary reserve funds. To assist in this the credit department steps forward with very valuable information from two additional files which it has been maintaining. The first of these is a record of all lines of credit which have been established by the loan or the executive committee. This shows not only the names of such lines, but also the amount now in use and the amount still subject to the call of the customer. There are many ways of employing such a file. It assists in planning secondary reserve investments by furnishing some idea of the length of time surplus funds will be available. It answers the oft repeated question, "Are we likely to experience a heavy demand for money soon?" by showing the amount of unused credit on lines under which the bank is obligated. Coupled with charts to show seasonal fluctuation in deposits, this file aids materially in obtaining maximum return from secondary reserve funds without sacrificing safety.

THE REDISCOUNT FILE

For primary or cash reserve problems, the rediscount file of the credit department is more valuable. When regularly revised, this shows at any time exactly how much paper is available for use at the Federal Reserve bank, permitting the officers to adjust their position with the minimum of effort and delay. Extra copies of the statements of all eligible borrowers are kept on hand for just such a contingency. Comparison of the totals of this file with the totals of the note pouch keeps the officers advised as to any trend away from a plentiful supply of rediscountable names.

Thus, warned, they can adjust policies in ample time to avoid the embarrassment of a shortage of available paper. If the file indicates that the bank is amply supplied, a move can be made to increase revenue by taking on a little greater proportion of paper which, while equally safe, bears a higher rate because it does not qualify for rediscount purposes.

It is becoming more and more common for some of the banks to convert suitable direct borrowing lines into bankers' acceptances. So the credit department enlarges the rediscount file slightly and subdivides it to show also what paper can be used in this manner. As the margin of safety in loans is approached, reference to the file shows those names which can be converted and sold to correspondents or through the regular acceptance brokers. This reduces the total of the loan account, releasing needed funds for other customers and producing more revenue.

These two files, namely, lines of credit and rediscounts, make up our fourth and fifth major tasks. Even with them an opportunity can be found for a use other than that for which they were first intended. Customers who have not been using their credit lines can be called on or written to and reminded of the bank's desire to extend credit. This must be done with discretion and at a time when the bank is in ample funds. It seldom, however, actually results in loans and does serve as an excuse for an additional contact with some desirable account. The compliment thus paid serves to tie the customer closer to the bank.

INFORMATION ON NON-CUSTOMERS

The work of the department so far

described has all been in connection with information on the bank's regular customers. We come now to the final phase of the work—the information on non-customers. In studying and analyzing the various loans in the bank, the credit department has become qualified both by training and by facilities to help others in credit investigations. Depositors and country bank correspondents are coming more and more to use this service: the customer, to obtain information to use in some prospective sale or business deal; the country bank, as a means of checking commercial paper names. In this way a direct service is performed for the bank's clientele and additional good will is created. Information once obtained to answer such requests is not destroyed, but is filed away to serve on future occasions when the same name is asked for. Thus is created over a period of time an extensive supply of information on non-customers. Designed primarily to save time in the credit department, this file is frequently referred to by notes, collection, and exchange departments as a source of information regarding the desirability of various drafts, checks, and acceptances passing through their hands. As an aid in checking unknown names, many credit departments maintain a record of the banking connection of most of the business firms in the city. This file is developed by watching the checks being deposited by customers and frequently serves others than those who originated it.

THE GRANTING OF AUTHORITY TO THE CREDIT DEPARTMENT

We have reviewed the main phases of credit work and have discovered

many ways in which this department directly and indirectly aids the entire bank. We have witnessed the development of valuable records for the use of the various officers and have suggested their cooperation in the maintenance of the credit file. Before closing I should like to urge the granting of certain authority to this department in return for the assistance it is rendering throughout the bank. It is charged with considerable responsibility in the acquiring and maintenance of all of the necessary information. There is even a tendency to extend this responsibility into criticism for failure to detect any unfavorable or dangerous signs disclosed by such data. I believe this to be a healthy and desirable trend, because the credit department, if properly manned, can frequently detect tendencies not so easily apparent to some one having personal contact with the borrower. But, in addition to the responsibility for detecting such signs, they should have the authority to carry what they find direct to the loan committee. I recommend this procedure in preference to taking it to the officer handling the account. He is often influenced by the personality of the borrower and under this influence permits the explanation made to him by the customer to outweigh his credit judgment. If the departmental warning seems worth while the committee is in a position to order an investigation, which either will allay any doubts or will show the need of drastic action. By using the impartial analysis of the credit department on all loans, this double check often uncovers weaknesses in time to get out without loss.

Naturally, if this plan is followed and authority delegated, the personnel

of the department must be such as can intelligently exercise it. As a matter of fact, whether you grant them authority or not, considerable care must be taken in selecting the members. This is the natural training school for future loan officers, and those permitted to enter should be qualified to assume later the greater responsibilities. No time should be lost in training them to the credit viewpoint, since otherwise they will lack the perspective necessary to develop valuable files.

With employees of this type and all of the agency services needed, expenses are bound to be large, and so far we have not pointed out any means of income. Our study has, however, I believe, shown that with the right personnel and the cooperation of the officers, this department can become so invaluable to the entire bank as to more than justify itself.

Discussion

THE CHAIRMAN: I should like to make a statement on my own behalf regarding expense, as far as the credit department is concerned, and the criticism that rests against it very frequently that it is an expensive department and not a productive department.

For as much as two years, before a good many groups of bankers, most of them senior bankers at that, I have been talking about the new business department that almost every bank maintains, with high pressure solicitors going out to bring in accounts. I, personally, do not think that the so-called new business department is a new business department at all. If there are two banks in a city, bank "A" and bank "B," each maintain-

ing one of these departments, and the solicitor from bank "A" goes out and persuades a customer of bank "B" to transfer his affiliation over to bank "A," and that customer begins to do his banking business with bank "A" in that new affiliation, there has not been one atom of new business created in the community. It is merely the same business that existed, diverted to a new home, and I think the so-called new business departments are simply departments for diverting business from one bank to another, not for the creation of new business.

With that as a premise, for the benefit of the credit man and the credit department, I offer this other suggestion: Just as the new business department keeps an accurate record of the business that is brought to that particular bank and then boasts to the senior officers and the board of directors of its wonderful accomplishments, and gets recognition in the limelight for that particular department, so let the credit department keep an accurate record of those accounts that have been small and have grown through its efforts, those accounts that have been involved in trouble and have been saved and made into productive units in the community. Let all of this growth in size of business, in vitality of business, and in soundness of risk be continually kept before these people who claim that the credit department is only an expense department. I believe very definitely and very firmly that the growth of a bank can be carried on more intelligently and more safely if it will do what Mr. Kimball said yesterday—"grow with its customers." The only way a bank can grow with its own customers

is through the cooperation of the credit department.

Don't let anybody "kid" the credit men or the loan men into believing that the credit department is not a productive department. If it were not for the combined credit departments of the banks of the country, there would be very little business brought in. Moreover, the business the credit department fosters should not be buried but should be carried in the front in our own publicity for the department and get the recognition it is entitled to. That is my own answer to this expense criticism.

JOHN L. BASCOM (First National Bank, Santa Ana, California): You stated, Mr. Blaine, that when the credit department has a criticism to offer, it should be taken directly to the loan committee. Wouldn't that have a tendency to arouse an antagonism on the part of the officers? They might think you were criticizing a superior officer.

MR. BLAINE: There is no question but that criticism of any particular officer's pet loan is going to create antagonism. In the particular case with which I am familiar, that matter was handled largely in the following manner: The credit manager sat in on all of the morning loan committee meetings. Thus he assumed a position similar to that of the loan officers themselves—at least, the junior loan officers. He was more or less one of them, and consequently his criticism was not considered as coming from a subordinate.

However, in order to ease the situation, the senior executive, who was in immediate charge of the credit department, brought up on the floor or

at the loan committee meeting all of the criticism. For instance, the trouble with the credit department account was discovered: falling off of balances, too many renewals without reduction, improper financial statement, and so on. The criticism was turned over, as soon as it was discovered, directly to the senior officer, a first vice president of the bank in this case, and was presented by him the following morning. On account of his high position in the bank the antagonism was smoothed over. There was no open flare-up or break. As we got more and more into the practice, the loan officers welcomed that sort of criticism. They felt that it was not destructive, or condemnatory of the officer's judgment, but rather was a suggestion.

THE CHAIRMAN: Would you not avoid a good deal of criticism if, in connection with your comment, which might be adverse, you offered a remedy which the loan officer having charge of the account could apply to that particular customer?

MR. BLAINE: Whenever a criticism was made, we naturally offered a remedy. The type of criticism, however, that usually comes up is not so much a criticism of the condition as it is a question of whether or not there isn't something possibly wrong. It is not a definite statement that the account is a poor account and should, therefore, be collected, but it is a statement to the effect that in our investigation we believe there is something wrong with that account and an investigation should be made. After the investigation has been made by the loan officer, or whoever makes it, and a bad spot is discovered in that particular risk, then the criticism of the loan can be proved to be

legitimate, and there is no question then of any antagonism. But the type of criticism that first comes up is not so much a definite statement that the account is a poor risk as that we believe there is something there that should be investigated, and then the committee usually gives its approval or passes it by as irrelevant.

WALTER B. SULLIVAN (Lincoln Alliance Bank & Trust Company, Rochester, New York): In our bank we have a tremendous problem with the small loans, and I am wondering if you can suggest to us how the credit department can assist in relieving this situation.

MR. BLAINE: In one of the banks with which I was connected in Seattle we made an analysis of our small loan situation, and it was a revelation. If I recall the figures correctly, there were about 3,000 individual loans, of which slightly under 2,000 represented loans of less than \$1,000. The 2,000, or two-thirds of the total loans, represented approximately \$500,000 in loans of a total of about \$15,000,000.

The small loan is a very important problem, and the greatest difficulty is the fact that we tend to lose track of it, it is so small. The individual comes in and says, "I have a \$200 loan; it isn't due today, but I want to renew it." Why waste the busy executive's time to investigate? It is renewed without investigation.

We evolved a system in that credit department whereby the responsibility for small loans was gradually taken over more and more by the credit department. We analyzed every loan of less than \$500 or less than \$1,000—whichever it was. We investigated the credit file and

found out how long it had been running, and whether the balances would justify maintaining it. If we found that it was a loan that had originated because of some friendship for a particular officer back two or three years before and had never been reduced a red cent, a file or card was made, and the day that loan came due it was brought up in the loan committee in this manner: "A loan of \$200 coming due today that has not been reduced in six months. Has no loaning account in the bank. Originally had some collateral, but it has disappeared."

That night the credit department again checked from that card and found out what had happened; if the officers had effected a satisfactory reduction it was filed to the next maturity. If, on the other hand, it was renewed without any reduction or the criticism was not considered, then it was brought up on the following morning and the officer was asked why it was renewed without taking the criticism into consideration. Thus we did not lose track of the small loan.

Gradually we found that these small loans began to disappear. Frankly, the plan was not in effect for a long enough time before I left the bank to enable me to know just how it came out, but we did detect an improvement in the small loan situation. The note was brought to the notice of the officers when it came due, and every officer was familiar with it. As a matter of fact, we even recommended that the credit department be used as far as possible in connection with small loans. We had some capable men in the department, and the suggestion was, "Here, why don't you say to the customer

that instead of taking up the time of the officer to analyze a \$200 or \$300 loan you will be glad to take care of him, and if he is entitled to the loan he will get it, but that all loans under that amount are being taken care of by the credit department?"

The loan may be approved immediately by the credit department, and if it is not, tell the customer that it will be taken up with the loan committee. It doesn't make any difference; you don't want the loan anyway in many of those cases.

EUGENE McELVANEY (First National Bank, Dallas): In connection with that procedure, did you increase the personnel of the credit department?

MR. BLAINE: No, in this particular case we did not. We had a department that was the result of an amalgamation. We had a credit department with three men and two women handling approximately \$15,000,000 in loans. We found out that at certain times of the year we were intensely busy, especially around statement time, but that at many other times the work was very slack, and then the clerks caught up on it.

MR. McELVANEY: The reason I asked was that we have a bank with loans running from \$50,000,000 to \$60,000,000, and at certain times we find that we have to double our credit department.

MR. BLAINE: If you find it necessary to increase the size of your credit department, I think you are justified in doing so. In this particular bank we made an investigation and found out that in charge-offs of \$25,000 in a year a large average was on loans of less than \$500 or \$1,000. We further found that

in 90% of those the credit file contained a word of warning but hadn't established a system which brought the matter to the attention of the officers on the morning the loan came due. The thing was simply allowed to drag on and on. So, the cost of increasing your credit department would be offset.

WILLIAM TONKS (Union Trust Company, Cleveland): I find that in my work it is necessary to impress upon all of the loaning officers of the bank that they are the most important members of the credit department—in fact, that they are the contact men of the credit department.

The main duty of the credit department, as I see it, is to conserve profits. When we give an adverse decision, some officers who are not so well trained as they might be as loaning officers feel that our judgment is bad unless the concern fails within a week. Many concerns are dead but are not embalmed or buried for several years, and the nicest little thing that you can do to encourage yourselves is to take either the yellow report from Bradstreet or the pink report from Dun, showing that a concern is in trouble, in bankruptcy or something of that nature, paste it on a white sheet of paper, and say at the bottom, "This concern made an application for credit at such and such date and we refused the loan," or "We retired from this loan for certain reasons and at such and such a

date." There may be quite a spread of time between the two dates.

Whenever any officer, especially in the sales department, comes to the conclusion that the credit department is a nuisance, pile those reports on his desk regularly for three months and he will never say another word about it.

WILLIAM J. SCHMITZER (Ohio National Bank, Columbus): In your file, you said nothing about real estate statistics.

MR. BLAINE: As a matter of fact, in connection with real estate in our particular city, I don't believe you will find a handful of real estate loans in any commercial bank. The question had to do with commercial banks, if you will refer to the program. Practically all loans of that type in our state are being made through mutual savings and loan companies, mortgage companies, and so on. We steer away from a loan predicated entirely on real estate as we do from mortgages. There is the necessity sometimes of making loans where a man's assets are largely in real estate, but that is usually on down town real estate property. You don't take on the type of the small individual who has a home equity, or anything of that sort. Therefore, you don't get into many cases of checking that real estate. The bank I am in now is so new that we haven't had occasion to do that. You have to check it very carefully.

The Commercial Sales Manager^{*}

By L. P. REED

SALES MANAGER OF THE MERCHANTS BISCUIT COMPANY, DENVER, COLORADO

Address before the Denver Departmental Conference

It is distinctly necessary to the success of any firm that the relations between the credit department and the sales department be harmonious and cooperative. Credit men should seek early and often the counsel of the salesman, since the latter's close contact with the customer gives him superior facilities for acquiring the intimate knowledge which must be obtained about the individual in question before it is safe to extend credit.

"A proper functioning of the two departments, with understanding and sympathy regarding each other's problems and responsibilities, will place each on a plane of utmost usefulness to the other and of maximum selling ability to the firm."

SUCCESSFUL business depends not only on the proper functioning of various departments, each important in itself, but also largely on the proper functioning of each department in cooperation with other departments. The sales department and the credit department are indispensable in merchandizing. The importance of cooperation between these two departments and the aid that each can render to the other is sometimes not fully appreciated. Conflicts too often arise between the operations of these two departments, to the detriment of the work of each and to the disadvantage of the institution to which they belong. Lack of cooperation has been one of the greatest drawbacks in selling and has ruined many business enterprises of considerable magnitude.

Without sales there would be no need for the credit department. The

credit department should therefore be developed as an asset to the sales department. It should be fully equipped to secure facts and furnish data, and have a personnel to assist in making proper sales. There has been considerable improvement in the relationship between these departments, but there is much yet to be accomplished before the ideal is attained.

Credit departments have published reports and rules to guide them in acting as guardians of the accounts receivable. They are, however, too often lacking in a method of ascertaining details concerning an individual customer, his status in his locality, his possibilities, and his limitations.

Salesmen can often inform credit men of a customer's history, character, moral responsibility, associations, reputation for honesty and veracity, location of business, financial standing, and business methods. The salesman is generally better fitted and has better contacts to secure such in-

^{*} This address and the two following addresses were given under the general heading of The Triangular Conflict.

formation than an employee of the credit department engaged for that purpose. Salesmen are often familiar, or are in a position to become familiar, with changes which have taken place since the last published reports reached the credit department. The salesmen can consequently form an additional staff to the credit manager at no additional expense, and should be so used by him. The credit department should educate the salesmen in the fundamental principles and operations of the credit department. Each salesman should be trained by the credit department to make a survey with a view to ascertaining whether or not a given customer is entitled to credit, and, if so, to how much. This enables the salesman in the first instance to pass on whether or not the customer is *prima facie* entitled to credit, and will relieve the credit department of some of its work and oftentimes save the firm the embarrassment of refusing credit after a salesman has secured an order. The credit department should obtain the good will of the salesman, and the salesman should be responsive to the aims of the credit department. Only by the development of a system including credit work by the salesmen and sales assistance by the men of the credit department can the best results be obtained for the firm. In this way the record, character, tradition, and financial responsibility of the customer can be ascertained. It cannot always be secured by the credit department working alone in its own offices. There must be in the department some men of tact, personality, frankness, and broad experience, able to do field work with the salesmen.

The credit department should in-

clude in its system of passing on credits, a gathering of data to enable it to understand conditions affecting the particular prospective customer. This cannot always be done by a review of information received by the credit department, but must go further and work out in individual cases an analysis of all the conditions surrounding the customer and his business. This can best be accomplished by intimate cooperation and study with the salesmen, and may require collaboration between a single representative of the credit department and the salesmen.

COOPERATION THE SECRET

The personnel of the credit department is too often made up of men who are bookkeepers, auditors, and accountants, and whose choice of work, training, and experience leaves them cold and impersonal in the handling of the credits of the customers of the firm. Some of the personnel of the credit department should be taken from the sales staff, and the personnel of the credit department should become to some extent "sales minded."

While no sale is complete to the extent of showing actual profit until the money is received for the shipment, the order must in the first instance be taken. This can sometimes only be accomplished by having a representative of the credit department go over the prospective customer's position with the salesman before determining whether or not that customer should be given credit. This may require a personal call by the representative of the credit department on the customer, and a survey of his business. To enable this to be

done most effectively, the personnel of the credit department must be conducted to cooperate sympathetically with the salesmen. Too often, after a salesman has collected information, the credit department ignores it and acts on information secured through channels which are insufficient to form the basis of sound judgment in the particular case. A failure by the credit department to have complete knowledge and understanding of the customer's position often results disastrously. The competitor who is more modern and efficient in his system of securing information about all of the factors involved gets the customer's business.

A CASE IN POINT

By way of illustration, the General Machinery Company, Charlie Knight, Credit Manager, declined a \$5,000 order from Blank & Company, upon which it was unable to obtain sufficient credit information. The salesman took exception to the decision of the credit department, and explained that subsequently a competitor had sold the machinery, upon the personal guarantee in writing of one of the officers of Blank & Company. He complained that an inspection of the prospective customer's plant would have convinced the credit department that the company was well equipped to carry on its business in a more economical manner by having the additional machinery. The salesman complained that the credit department had not made a thorough and complete investigation of the particular customer's position. Mr. Knight, Credit Manager, answered that he had been unable to obtain, through regular

channels, sufficient information, and that the customer's record was too limited to indicate that the firm would be able to take care of such an obligation. He further stated that he had relied to a great extent upon information from the Service Bank.

The competitor who took the order wrote his bank in detail, setting forth his knowledge of Blank & Company, and the bank answered in detail. The competitor sent one of its credit department men with the salesman to interview the officers of Blank & Company, with the result that one of the officials felt confident of his company's ability to pay and personally guaranteed the account. The matter, involving a \$5,000 order, was given more attention by the personnel of the competitor; and the field work done, together with a fuller discussion with the bank, resulted in the conviction that it would be safe to extend the credit. This experience not only lost the order for the first salesman's firm, but tended to discourage the salesman in his work for that firm. Inquiries and investigations concerning particular orders and particular customers can only be handled by a consideration of all matters concerning the transactions and by the utmost cooperation between the two departments.

A proper functioning of the two departments, with understanding and sympathy regarding each other's problems and responsibilities, will place each on a plane of utmost usefulness to the other and of maximum selling ability to the firm. Such intelligent and cordial cooperation will prevent conflicts between the two departments and between each department and the management controlling both of them.

The Commercial Credit Man^{*}

By CHARLES R. KNIGHT

CREDIT MANAGER OF THE PITTSBURGH PLATE GLASS COMPANY,
DENVER, COLORADO

Address before the Denver Departmental Conference

A credit department, according to Mr. Knight, must not be expected to stake the safety of the firm of which it is a part on the financial responsibility of a customer without full and adequate evidence that the gamble is justified. That evidence must comprise facts, and these facts are extraordinarily difficult to obtain. The inquiries sent to banks meet often with very unsatisfactory response, glittering generalities taking the place of statistics, and courteous effort at cooperation being rare.

Mr. Knight quotes several of the disheartening replies he has received to his requests for information, and concludes that there is a pressing need for more vigorous teamwork between the commercial house and the bank.

LET me base my talk on the particular situation which the previous speaker outlined for you. The credit department of the General Machinery Company, under my direction, turns down a large order when it has been unable to obtain sufficient credit information to enable it to pass the order. Mr. Reed, the sales manager, has taken exception to the decision and is disappointed because of the loss of the business. The credit department fully appreciates his position in the loss of a nice order, but is of the opinion that if he will analyze the situation from the facts, he will see the logic of the credit department's action.

The Blank Machinery Company is young and comparatively new in the field; consequently it has not estab-

lished itself in trade circles. Its trade record is okeh as far as it goes, but its operations thus far have been small and limited, and in view of a sudden spurt of heavy buying and present business conditions, caution should be used.

The customer has refused to furnish agencies with a financial statement and has made no reply to our direct request for a statement. Had the salesman, while on the ground, made a more thorough investigation locally—and no doubt he could have secured a statement at the time, had he explained to his customer that, the order being rather large and the first, his company would require a financial statement and it would be nice if he could send it along with the order—there is little doubt but that the customer would have furnished the statement and the order would have been saved.

It is true that the officials repre-

* This address and the one preceding it and the one following it were given under the general heading of The Triangular Conflict.

sent some financial strength personally, but it must be remembered that the Blank Machinery Company is a corporation, and the officials are not liable beyond the funds they may have invested in the company. The officials were approached for a personal guarantee and this was refused. The very fact that a personal guarantee was deemed necessary, would indicate that the company was not properly financed. Investigation reveals the fact that our competitor has been a customer of the bank for some years and was favored with information that enabled him to ship the order. As we are not a customer, we received only generalities. It was further revealed that the Blank Machinery Company is also a customer of the bank, and its officers were influenced to give their personal guarantee as security for the order.

The information given by the bank is all right as far as it goes, but the transaction is of too great importance to be handled on information dealing only in generalities. Banks as a rule are reluctant to give out information of a concrete nature regarding a customer, their excuse being that the request has not been made in proper form.

SPECIMEN INQUIRY AND REPLIES

My inquiry to the bank was made as follows:

In Re: The Blank Machinery Company, Hillside, Texas
Gentlemen:

The above-named company has applied to us for a larger line of credit than usual and has referred us to you as to its ability to handle a larger line of credit.

Our past dealings have been pleasant and satisfactory over a period of

one year, with the following situation:

Credit	\$2,750
Owing	1,750
Overdue	_____

As a rule this company discounts or pays at maturity of invoice on our terms of 30—2%—10 days. It is now applying for a line of from \$5,000 to \$10,000.

We should appreciate having, if consistent with your custom, the result of your experience in any transaction you may have had with the firm.

Thanking you in anticipation of a reply and assuring you of our readiness to reciprocate at any time, we are, . . .

The following is the bank's reply:

Dear Sirs:

We have your inquiry of July 2 regarding the Blank Machinery Company, and in response are pleased to inform you that an account has been carried with us since the company's formation in 1922.

The management is experienced, and, we consider, capable. Its financial responsibility is rather limited, but we think it will not contract beyond its ability. This is merely an opinion, however.

The company's borrowing record with us is satisfactory.

Very truly yours,

Just to give you an idea of what I am sometimes up against, here are a few other banks' answers to inquiries:

Dear Sirs:

The ——— Company, about which you inquired on June 1, has conducted an account with us for several years.

The relation throughout the period has been satisfactory, and, judging from our experience, we believe the company is a good risk for ordinary requirements.

This answer tells nothing; in other words, it does not give the bank's actual experience with the ac-

count. It does not state whether the company borrows, and, if so, upon what basis. It gives no financial information whatever, and expresses no opinion as to the character and ability of the management. In short, a letter of this kind performs the useless function of adding to the bulk of a credit file and is of little or no use as an aid in forming an opinion as to the desirability of a credit risk.

Here is another answer:

Dear Sirs:

We do not have the account of the _____ Company, about which you inquired on August 30, although it is casually known to us in a favorable way.

We are inclined to believe that it will make no contracts beyond its ability to retire as agreed. This is merely an opinion, however, and expressed without liability on the part of this bank, or of the writer.

The writer of this letter might just as well have saved his time and energy, for all the good it did the company making the inquiry. He expresses an opinion not based on facts and then disclaims any responsibility for it. Apparently he didn't even take the trouble to call up the bank having the account to find out about the bank's experience with it.

Still another specimen:

Dear Sirs:

The subject company named on the reverse of this form does not do business with us, and we regret to inform you that we have no information on file pertaining to it.

The banker who answered this inquiry is apparently very discourteous.

He didn't even go to the trouble of expressing an opinion, let alone obtaining an expression from the bank which had the account.

The company which made the inquiry didn't know where its prospective customer did its banking business, so sent out a form letter to every bank in the city.

(The banker, having received so many inquiries of this nature, naturally assumes that all the other banks in the city have received this one—hence the curtness of his reply.)

The banking profession maintains that inquiries are not properly made. Here is an example of a credit inquiry received by us from a national bank:

Gentlemen:

We should be pleased to have you give us, in confidence, any information you may have concerning the financial responsibility, general standing, character, and integrity of the _____ Company, and, if consistent, the result of your experience in any transaction you may have had with it.

Thanking you in anticipation of a reply, and assuring you of our readiness to reciprocate at any time, we are, . . .

The letter tells us nothing, does not even indicate whether the subject is an old depositor now seeking credit, or a new applicant for credit.

It would seem that the banks and commercial houses could work out some plan for closer cooperation in the matter of credit information, and thereby help save the business from inflicting a loss on its creditors and make it, instead, an asset to the community.

The Financial Credit Man^{*}

By EUGENE McELVANEY

ASSISTANT VICE PRESIDENT OF THE FIRST NATIONAL BANK IN DALLAS,
DALLAS, TEXAS

Address before the Denver Departmental Conference

Mr. McElvaney presents the bank credit man's side of The Triangular Conflict, the conflict existing between the bank credit man, the sales manager, and the commercial credit man. He realizes fully the responsibility of the bank in such matters and feels that conflict could be eliminated very easily if the commercial credit man would follow the seven suggestions he offers; the suggestions are taken largely from the code of ethics formulated by the Robert Morris Associates:

1. Be sure that the size and nature of the transaction at hand justify a checking through the customer's bank.
2. Avoid the use of forms so far as possible at least for bank use.
3. Be sure that the name and initials, if any, are correctly stated; and, if not well known, give the street address or office building in which the subject is located.
4. Every inquiry, form or otherwise, should bear the manual signature of the sender to help establish responsibility.
5. State your own experience.
6. State the approximate amount of credit involved.
7. Through cooperation with your sales department, ascertain wherever possible the name of the customer's bank, and save yourself the trouble and us the annoyance of broadcasting your inquiries to every bank in the vicinity in the hope of reaching the right one.

I SUPPOSE our complex American business life will always be fraught with conflicts of some kind or other. We no sooner get one ironed out than some new trend or development in business enterprise gives rise to another. But this age old psychological conflict between the sales mind and the credit mind seems to have followed the course of business through all of its varying fortunes, and even today, amidst our unremitting preachments on "love one an-

other" and cooperation, we still find the struggle going on. It is like the commonly known eternal triangle in society, and while I know of no instances on record where the sales-credit conflict has been settled by a shotgun or a sixshooter, it has frequently been carried almost that far.

There has always been too definite a line of demarcation between the sales end of business and the credit end. Until recent years they have occupied two different worlds, inhabited by different types of individuals. To the credit man, the salesman has been a happy-go-lucky

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creature, a hail fellow well met, entirely lacking in judgment, who with appalling indiscrimination sells every Tom, Dick, and Harry who can sign an order blank, and many who cannot. In the eyes of the salesman, the credit man has been a narrow-minded, hardboiled autocrat, who thinks it his duty to say "no" as many times as possible without losing his job. Happily the conflict is becoming less pronounced. Wise business men are gradually recognizing the necessity of more closely coordinating their sales and credit policies; they are finding that these two factors of business should not be divorced, but should be happily married, one working with the other for a common objective. This very discussion here today affords abundant evidence that we at least recognize the problem, as well as the importance of joining hands in its solution.

FUNCTIONS OF THE BANK CREDIT DEPARTMENT

I have somehow got the idea from my predecessors in this discussion that perhaps the bank credit department is the monkey wrench in the machinery. Occupying the third position in this triangle, I have no disposition to dodge the responsibility attached to that implication. But I do want you to bear with me a few minutes in determining just where the bank credit man stands in this interesting picture. What is your conception of a bank credit department? What is it for? I believe it is almost necessary to have a clear understanding of the functions of this particular phase of bank operation before we can proceed intelligently with this discussion. Briefly, to my

mind, the three chief functions of the bank credit department are these:

1. To maintain an adequate system for gathering, assembling, and analyzing credit information pertaining to the bank's customers, to the end that the bank's loaning officers may at all times have an up to date and accurate picture of the risk in each case
2. To develop credit information for the bank's own customers
3. To answer legitimate credit inquiries regarding the bank's customers.

I regard the last named function as being just as important as the other two. Every customer of a commercial bank, whether an individual, a firm, or a corporation, has a perfect right to expect that such credit inquiries as may be directed to his bank regarding him, when coming from sources known to be entitled to the information, shall be given prompt and proper attention; shall be answered as fully and intelligently as may be consistent, on the one hand, with the nature and scope of the inquiry, and on the other with the rights and interests of the customer and the sanctity of his relations with the bank. Such attention to credit inquiries is an important part of our job; it is an important part of the bank's service to the customer; it is an important part of our responsibility; and no bank credit man, in my opinion, is qualified for his position who takes any other view of the matter.

I have purposely emphasized this feature of the bank credit department, because I want my friend the sales manager, and my friend the commercial credit man to realize above all things that we bank credit men do recognize our duty in this respect; and that rather than shirk-

ing our responsibility, we are anxious to cooperate with them; we want to answer their inquiries and we want to answer them as fully and as intelligently as we can, not only as a service and a courtesy to them, but as a fulfillment of our obligation to our customer. Whatever may be the trouble, I think I may safely say that, at least in most instances, it is to be found elsewhere than in our attitude toward furnishing information to the commercial credit man.

What, then, is the basis of the criticism so often lodged against the bank credit man for his apparent indifference toward inquiries originating in the trade, and for the paucity of information so frequently to be found in his replies? There are several reasons, which I shall discuss later on, but I think they may all be epitomized in this one general statement: The average commercial credit man too often places the bank in the same category as all other sources of credit information, when it is not in the same category at all; he makes the bank just another cog in his credit checking routine, just another name on the file to receive the same type of inquiry that goes to the trade creditor; and so long as that attitude persists, so long as the commercial credit man regards the bank as a common bureau of credit information or as an ordinary credit interchange service, just that long will he fail to receive the wholehearted and helpful cooperation that we are anxious to give and that he is entitled to receive.

THE BANK, THE COMMON DENOMINATOR OF CREDIT

It has been well said that the bank is the common denominator of credit.

It comes in contact with all the steps in the processes of production and distribution; it acts as financial adviser as well as credit grantor; it naturally has a closer contact with the customer in most instances than that of a mere buying and selling transaction. By reason of this well rounded relationship, it is familiar with many phases of the credit risk not directly available to the trade creditor or the mercantile agencies. Such information obviously cannot be dealt out promiscuously. It is available only on the basis of mutual confidence, and that confidence cannot be established through the average form of trade inquiry that reaches the bank credit department. The commercial credit man should reasonably expect to receive more valuable information from the bank regarding its borrowing customers than perhaps from any other source, and it stands to reason, therefore, that if the inquiry originates through transactions of such size and importance as to justify a checking through the bank at all, it is worthy of a little more time and attention in its preparation than the ordinary trade inquiry.

And let me say here in passing that in my opinion many bank inquiries should be eliminated altogether. I hardly know how to go about estimating with any degree of accuracy the proportion of absolutely needless credit inquiries, but I do know from experience that in a large percentage of cases information readily obtainable through the regular established credit agencies and interchange bureaus would be entirely sufficient to pass on the amount of credit involved. For instance we not infrequently receive inquiries regarding nationally known business con-

cerns of unquestionable strength and standing in connection with orders for ridiculously small amounts. This useless exchange of credit correspondence clogs the wheels and helps to build up a feeling of annoyance on the part of the bank credit man in having to take time to give out information which is quickly available through half a dozen sources almost at a moment's notice. In the elimination of thousands of these useless credit inquiries, our problem would be materially simplified.

TECHNIQUE IN CREDIT CORRESPONDENCE

We are perfectly willing to recognize the ability of the commercial credit man to know how to use information from a bank, if and when he gets it; a thing we should like to help him do if possible is to improve his methods of getting it. There is a technique in credit correspondence, just as there is a technique in any other highly specialized operation; and there is a code of ethics in the interchange of credit information. The Robert Morris Associates, which is the bank credit man's division of the National Association of Credit Men, and which includes in its membership some four hundred of the leading banks of the country, has undoubtedly done more to develop this technique in credit correspondence and to promulgate a definite code of ethics in the interchange of credit information than any agency I know anything about, and the entire background for this part of the discussion is to be found in its splendid work and policies.

Asking for credit information seems such a simple thing, and yet

it is surprising, the thousands of dollars wasted each year in poorly prepared credit inquiries that fail to produce sufficient helpful information to justify the expense of sending them out. It would really be interesting to know the number of casualties among credit inquiries; I know there are hundreds of them in the mail we receive. And the astonishing thing to me is that the same habitual offenders never seem to tire of pouring in a continuous stream of these hastily prepared forms, whether they produce anything worth while or not. They seem to attach more importance to the physical routine of sending out a certain number of inquiries and getting replies, than actually to developing useful information to assist in passing on their credit risks.

Homely as the comparison may be, asking for credit information is a good deal like making love. The success of a credit inquiry, like the success of a love letter, is seriously impaired by formality, by trite phrases and hackneyed expressions, by lack of frankness and sincerity, by such inexcusable errors as omission of signature, misspelled words, or incorrect initials or address. If some commercial credit men, and bank credit men, too, for that matter, make love the way they ask for credit information, there must be more bachelors in the credit fraternity than in any group I know.

SAMPLES OF CREDIT INQUIRIES

Let me illustrate. Here is an ordinary sample of credit inquiry we receive from the trade every day. It has not been concocted for this particular discussion, but merely selected at random from our daily mail.

If it is impossible to answer all of the above, please answer what you can.

They seem to have overlooked requesting a sample of the victim's finger prints, and the size shoe he wears. It reminds one of a cross between an income tax return and a life insurance application. It is needless to say that we never attempt to fill out one of these complicated questionnaires, and I know of no bank credit man who does. I imagine the sender of such an inquiry would be overcome with shock if he should open his mail some morning and find all of his questions answered in detail.

Here is another one:

third sample which follows hardly needs comment:

First National Bank,
Dallas, Texas.

Gentlemen:

We shall be pleased to have you favor us, in strict confidence, for credit purposes only, with such information as you may possess regarding Thackers Root Beer Stands, 1527 Elm St., Dallas, Texas.

Thank you. We are always glad to reciprocate.

Yours very truly,
(Unsigned) John Doe Company

Age

First National Bank
Dallas, Texas

Gentlemen:

Kindly favor us, in confidence, with your experience and opinion of the concern herein named.

We shall gladly reciprocate the courtesy.

Yours truly,
A. B. C. Company

M. Grobstat (Elm Street Store), Dallas, Texas.

Sold since	MANNER OF PAYMENT
Terms	Discounts
Amount Owing \$.....	Prompt and Satisfactory
" Past Due \$.....	Slow but considered good
How long Past Due.....	Unsatisfactory
Highest recent credit \$.....	Sell for cash only
Unfilled orders \$.....	Settles by Dated check
Is account guaranteed or secured?	Settles by Notes
.....	Collected by Attorney

Any other information at your command, which you care to give us, will be appreciated.

(Unsigned)

This form of inquiry is manifestly intended for trade creditors and is in no way applicable to a bank. This

Married
Occupation
Character

Reputation for honesty.....
 Is this party prompt and reliable?...
 Has he any property?.....
 Value of same.
 Remarks

much better results they would receive from their inquiries!

STATEMENT OF AMOUNT INVOLVED

STATEMENT OF EXPERIENCE WITH THE ACCOUNT

Two things are necessary to elicit the full cooperation of the bank credit man in answering an inquiry. In the first place he must know beyond any possibility of doubt that the sender of the inquiry is entitled to the information. This, the commercial credit man can best evidence by giving his own experience with the account, which, you may be sure, is far more valuable than twenty-five cents in stamps which sometimes accompanies the inquiry. It acquaints us with the nature of his problem. Confidence begets confidence, and the more we know of his side of the question, the further we are disposed to go in giving our side. If it is a first order, the inquiry should so state. If the account is of long standing, the inquiry should say so. If the subject has fallen behind in his payments, it is not unlikely that we may know the reason he is behind, and can offer a satisfactory explanation. If he takes unfair advantage of discounts, that is information that is valuable to us. Perhaps it will give us an opportunity to help straighten him out. Most inquiries we receive add that gracious, courteous expression: "We shall be glad to reciprocate when called upon." If commercial credit men would do a little more reciprocating in advance how much easier our task would be, and how

The second requisite to a successful credit inquiry is a definite statement of the approximate amount involved. Manifestly an inquiry in connection with a transaction involving several thousand dollars would be treated far differently from one involving less than \$100. We received an inquiry the other day from the credit manager of one of the larger oil companies requesting information regarding the financial responsibility and standing of another oil company, our customer, representing a net worth of over \$2,000,000. While we were not familiar with the credit man's signature, we knew him in a general way and knew that he was entitled to a frank discussion of the subject's affairs. The nature of the transaction was not disclosed in the inquiry, but we were perfectly justified in assuming that there must be some important transaction, because both concerns are accustomed to dealing in rather large figures. Accordingly we went into considerable detail. We discussed something of the history of the business, the character and ability of the personnel, the progress of the company over a period of years, outlined in a general way what we did for the concern in a credit way. In other words we gave him as complete a picture of the organization as we thought would be helpful in passing on a substantial transaction. Some days later I had occasion to visit this particular credit manager, rather expecting to receive at least some mention of the trouble I had taken in

answering his inquiry. When no reference was made to our exchange of correspondence, I finally asked him what sort of deal they had on with the oil company about which he had recently inquired. To my surprise he knew nothing of the inquiry, and upon investigation he found that it had originated in his department in connection with minor credit transactions involving around \$100 a month. The subject company, it seems, had been buying gasoline for its trucks in the field, and had requested customary credit privileges. In the first place there was no occasion for a bank inquiry; assuming there was, however, a simple statement of the approximate amount involved would have enabled us to answer the inquiry in an entirely satisfactory manner in one sentence.

SAMPLE OF EXCELLENT TECHNIQUE

These two cardinal principles of a credit inquiry cannot be better illustrated than by reading what to my mind is a perfect example of that high type of technique in credit correspondence to which I have previously referred. This letter, like the ones previously quoted, is not manufactured, but has actually been taken from our files.

First National Bank,
Dallas, Texas.
Gentlemen:

In RE: The Subject Company
No. 3435 X Street
Dallas, Texas

We would appreciate and value as comprehensive an expression of your opinion as you may feel in a position to give us respecting the financial and general standing of the above name.

If you can consistently furnish us

with the maximum line of unsecured credit that has been established and whether its use has been continual, together with their indebtedness today, it will be most helpful to us. May we further ask whether balances have been commensurate?

For your confidential information we have before us for consideration an order amounting to approximately \$1,000, and from investigation made at this time in the trade we are led to believe that on January 1, 1929, they had a net worth of \$32,957.64, after considering debts of \$11,716.88, with merchandise of \$31,275.53, accounts \$3,952.75, cash \$9,446.24. A recent checking quotes them as paying promptly.

You have our assurance that your confidence in favoring us with a candid reply will not be violated; for we shall make discreet use of the information. If you will accord us the pleasure of serving you in a like manner at any time, we shall repay your kindness.

Very truly yours,
(Signed by the Company's Credit
Manager)

This credit inquiry has the essential characteristics of a perfect request for credit information from a bank. The writer was a total stranger to us, and yet after reading his letter we felt some kinship toward him; we felt that we had come together on a common meeting ground; we felt that our confidence was justified and that we were rendering a mutually beneficial service by writing the most complete, painstaking credit letter on the subject of which we were capable. And that is the reaction of every bank credit man to that type of inquiry.

When I go through our credit mail in the morning, I make two stacks. In one stack I place all the form inquiries that have the well known earmarks of a routine checking. These are turned over to the general credit department where they are ground

through the mill in pretty much the same manner as they were sent out. If the subject is not our customer, the inquiry will likely receive the imprint of a rubber stamp to that effect, and if accompanied by a return stamped envelope the sender will get this little prize package of information that does him about as much good as though he had written Santa Claus. If the subject is our customer, we are forced to gauge our reply pretty much by the type of inquiry, and I think it can pretty well be said that the time and attention devoted to the reply just about equals the time and attention given to the inquiry when it is mailed out. If the inquiry has a definite objective, it gets a definite reply if we are able to give it. If it is phrased in vague, general terms, it necessarily gets a vague, general reply.

In the other of these two stacks I place such inquiries as the one I just read, because I believe they are deserving of special attention and I see to it personally that they are answered as fully as though the man at the other end of the line were sitting at my desk and I were discussing the matter with him in person.

ROBERT MORRIS ASSOCIATES CODE OF ETHICS

In closing the discussion, then, I would offer the commercial credit man these few simple suggestions, taken largely from the code of ethics formulated by the Robert Morris Associates:

1. Be sure that the size and nature of the transaction at hand justify a checking through the customer's bank. Paraphrasing the political advocacy of "fewer laws and better laws," let me urge that

we have fewer inquiries and better inquiries.

2. Avoid the use of forms so far as possible, at least for bank use. Each credit transaction is usually deserving of special treatment, and form inquiries attempt to reduce all such transactions to the same basis. Questions applicable in one instance will be totally out of order in another, and if the form includes sufficient questions to cover all instances it becomes burdensome and confusing. If forms must be used, at least see to it that the form is adapted to bank use. Nothing is more annoying to a bank credit man than to be asked for the high merchandise credit extended and the terms granted.

3. Be sure the name and initials, if any, are correctly stated, and, if not well known, give the street address or office building in which the subject is located.

4. Every inquiry, form or otherwise, should bear the manual signature of the sender to help establish responsibility.

5. State your own experience.

6. State the approximate amount of credit involved.

7. Through cooperation with your sales department, ascertain wherever possible the name of the customer's bank, and save yourself the trouble and us the annoyance of broadcasting your inquiries to every bank in the vicinity in the hope of reaching the right one.

If commercial credit men will but give serious consideration to these few common sense principles of credit correspondence, I believe I can guarantee that their returns will be much nearer a hundred per cent complete, and the casualties among their credit inquiries materially reduced.

Discussion

THE CHAIRMAN: Before we open the meeting to general discussion, I should like to place myself on record

as absolutely against any form for bank inquiries. The inquiries will only be cheapened by being fed through typewriters by junior clerks, and will not bring results any more rapidly than do the present methods.

ALEXANDER WALL (Robert Morris Associates, Lansdowne, Pennsylvania): Before you get to definite questions, I want to say something following what you have just stated and suggested by something Mr. Knight mentioned in connection with the development of a form to be used in addressing letters by commercial men to banks.

I should like to put before the meeting the fact that about four years ago the National Association of Credit Men was determined to develop such a form, and called upon the Robert Morris Associates to help them in its development. A committee from the National Association of Credit Men was formed, and the Robert Morris Associates met with them to discuss this problem and were in conference about two days.

That matter has been considered time and time again, and the outcome so far, for a period of about three years, can almost be epitomized by what Mr. Tonks has just said: that the commercial man, or any other man who wants to get any information of that type from a bank, must construct a letter that will apply to the particular case. Every case has special angles to it that preclude the use of forms.

The Robert Morris Associates, representing a large number of banks, maintain a committee on credit practices which is constantly reviewing inquiries that come to the members from the members. I am the advocate of a committee of the same kind in the

National Association of Credit Men, to review commercial inquiries and then establish a contact between these committees, whereby the stream of inquiry letters and of replies may be reviewed by a joint committee to work out a solution. Bank men are quite as much interested in maintaining the credit standing of commercial houses—their own customers or otherwise—as the commercial credit men are, and only by doing that will they get the proper cooperation.

I should like to ask the first question in this discussion. Mr. Reed stated that the credit department should really be an asset to the sales department. I should like to ask Mr. Knight whether he now considers the credit department a liability to the sales department, and how he could correct that fault.

MR. KNIGHT: That is a pretty tough question, Mr. Wall, but I think the credit department would be well on its way to the scrap heap if it were not for the sales department, and that the sales department wouldn't last long if it were not for the credit department.

It is true that in past years a credit department in a commercial house was just a nominal affair. The salesman would come in with his long story to the big boss, the sales manager, and when it was all said and done, even when the credit man got all the information he could and it was adverse, the sales manager would say, "Well, we want all the volume we can get, so let's take a chance," and there you are. But that is changing all the time, and a credit department, commercially, is now given more responsibility and is looked up to more than before.

In my own practice I try to put

myself in the salesman's shoes, because I have been out with our own men in their territory and realize what they are up against, and also realize that a salesman, in selling an order, is inclined to be more enthusiastic or optimistic than he would have been had he been called upon to dig down in his pocket and lend \$100 of his own money rather than the company's. He wouldn't do it if he had to give his own money, but it is the company's, and in the case of final loss the credit man has to do the explaining. However, salesmen are coming to see the side of the credit man, too.

We have a form for our salesmen which puts them on record as to their opinion of an account. It gives the style of the company, whether a partnership or a corporation; and, if a corporation, the name or style used. If it is a partnership, the names are required, and the order is carried in those two personal names, the style being carried as secondary, only to identify it. We want to know the customer's banking connection, his line of business, and his idea as to the value of the stock; whether his company is amply insured, and, if possible, several of its mercantile references. If it is impossible or embarrassing to ask those questions directly, the salesman can see the lines the man is carrying on the shelf; that will indicate where he buys, and the salesman can put the facts down on the form and sign the form.

Unless this is done, six months afterwards, when we are called in and say that the salesman recommended this or that, it is easy for him to pass the buck—that old army game. We should have his ideas and recommendations over his own signature, in

black and white. It doesn't take long to educate salesmen when they put such a record down over their own signatures.

THE CHAIRMAN: Let us put it this way: a sale is not completed until the bill is paid. When an order is put through in the face of the adverse decision of the credit department, it makes the credit department a collection department.

PETER C. JANSEN: (Manufacturers & Traders Trust Company, Buffalo): I should like to ask whether or not the saving of credit losses is more important than the establishment of new business or good will.

MR. REED: Fortunately, or unfortunately, in the firm I represent and the business I have represented for years, the credit department functions with the sales department almost as a single unit. In our particular business, we have determined that it is wise to take a chance on almost any first order. We do it for good will and for increased volume, and from that time on we determine whether this new customer is entitled to further consideration.

KATHLEEN J. SWEENEY (Manufacturers & Traders Trust Company, Buffalo): I should like to ask Mr. McElvaney whether he thinks the bank should endeavor to secure information regarding a non-customer, and how far it should go in that direction.

MR. MCELVANEY: I should say distinctly, "no." As I pointed out in my remarks, I don't believe that a commercial bank should be a credit bureau at all. In our bank we answer credit inquiries only to help establish our own customers in the trade. When we place our credit department in the position of having to go out and develop information on the trade

of people not numbered among our customers, I think we are going entirely outside our field.

JOSEPH R. LORETT (Colorado National Bank, Denver): Would the fact that a trade inquiry may or may not be accompanied by a fee of twenty-five cents have any influence with Mr. McElvaney in his reply or in his attitude toward the inquiry?

MR. MCELVANEY: It wouldn't have the slightest bit of influence with me whether the inquiry were accompanied by a twenty-five-cent fee, or even a fifty-dollar fee. If the inquiry pertained to our customer and was couched in such terms as to let us know that the sender was entitled to the information requested and it would help to establish confidence in our customer, we would go just as far in giving out that information if it was not accompanied by a fee; but if the inquiry did not concern our customer, we would not bother with it.

MR. JANSEN: Do you keep the fee?

MR. MCELVANEY: No.

HUBERT E. PIERCE (Trenton Trust Company, Trenton, New Jersey): Should the credit department handle accounts by an ironclad, fixed rule, or on an individual basis?

MR. REED: With concerns operating nationally or having branches throughout the country, it is my belief that you should have a more or less fixed rule. With so-called local concerns, you can often operate more successfully in handling cases individually, although necessarily you may have more or less fixed terms. We find that we gain a good deal of extra business and good will by extending credit other than on our regular terms in particular cases.

THE CHAIRMAN: When you ship

the first order without credit inquiry, is that for small or large amounts?

MR. REED: The majority are for small amounts.

MR. WALL: About three years ago, one of the members of the Association sent to the office an inquiry letter he had received—one of those terrible inquiry letters that ask nothing about nobody in any particular place. It came from the credit manager of a very large concern. That was the typewritten part of the signature, and there was a name after it. The member said that he had received a number of inquiries from that particular company, and he wanted to know if something couldn't be done about it.

I took a long chance and wrote a letter to that company from our office. I said that their type of inquiry letter had been called to our attention, and asked if they would like to know how to construct a credit letter calculated to bring an answer from the bank that would be worth while. I have never received a reply to that letter of mine. I should like to know whether I did the right thing.

MR. KNIGHT: I should say, Mr. Wall, that you were quite right to call that commercial man's attention to the form of his inquiry. Personally, if I had written such a letter and you had called my attention to it, I should at least have given you the courtesy of a reply, and then endeavored to make the inquiry correctly and co-operate to the fullest extent.

While I am on my feet, if the chairman will permit me, I should like to make a further comment about what I said regarding a stereotyped commercial form to be sent the banks.

What I had in mind was this: a form transmitted by your board of

directors to the National Association directors, giving your code of ethics. I should have the National Association of Credit Men hand it down to the boards of directors of the different local associations and start a school, as you might call it, devoted to making the proper form of inquiry to banks.

MR. WALL: I have been invited to attend a board of directors' meeting on something like that.

MR. KNIGHT: I believe it would work out well, in that it would come down from the National Association to the local associations, giving information of the proper type to commercial men and furnishing them with a copy of the code of ethics of the Robert Morris Associates and other banking fraternities.

CHARLES C. KIMBALL (The Merchants National Bank of Boston, Boston): I should like to ask Mr. McElvaney two questions, which I think are interrelated. First, how far do you think, in answering trade inquiries, a bank is justified in disclosing the amount of credit which it is extending? Second, in making inquiries in the trade, should a bank volunteer its own experience with the account?

MR. MCELVANEY: In answering a credit inquiry which is entitled to receive information, I assume, not that I am extending a courtesy to the sender of the inquiry, but that I am rendering a service to our customer; and I am guided largely by the motive of trying, if possible, to help our customer. We wish to help him to establish himself in the trade and to establish his credit in the trade.

If we feel that the inquiry justifies our going into detail, in some cases we feel at liberty to tell how far we

go in a credit way. In the case of other inquiries, the amount involved may be so small that we don't consider it necessary to go into so much detail. Amounts of \$100 or \$150, we think, are not sufficient to justify going into detail.

Ordinarily, we withhold that information unless the circumstances justify our giving it. At all times we are mindful of the sanctity of the relation of the customer to the bank.

MR. KIMBALL: Your relations, as trustee, with your customer, would also prevent you from volunteering information about that account, would they not?

THE CHAIRMAN: Mr. Knight, would you like to say something on this question?

MR. KNIGHT: If an inquiry comes to my desk on one of my large customers, which I believe would justify a reply, I should want to know how large the order was before I would divulge that information, since a commercial firm, such as the firm I represent, acts to a great extent as the banker of that customer. Often, in our line of business, we find that a customer hasn't assets of sufficient security to place himself in the proper standing with the bank, and we, in a sense, act as his banker. I feel, as the bank credit man feels, that, if the amount involved is only about \$50 or \$75, the inquirer is not entitled to that information. However, I believe that otherwise I am justified in giving the facts as they appear on the ledger. If they are not right, it is the fault of the customer and not of the creditor. That is the attitude of the bank: that it is doing the customer a favor and helping to establish him in the trade.

THE CHAIRMAN: May I add to that? A great deal of what I say

along these particular lines is possibly justified by what my customer himself publishes through Dun or Bradstreet; also, by whether the name is upon some stock market where certain information must be given and can be purchased. Possibly I can help the inquirer by giving that same information without putting him to the trouble and expense of getting it through some agency. My customer cannot complain, when he publishes the information himself.

MR. KNIGHT: It occurs to me also that when a customer sees fit to name a given agency, whether a bank or a commercial house, as a reference, he can't take exception to any legitimate answer being given by the bank or commercial house as to his financial standing with that particular organization.

FRED HOULE (Fort Worth National Bank, Fort Worth): What are the objections to banks' giving their experience in dollars?

MR. MCELVANEY: I believe that question has been pretty well covered in our previous remarks. Our objection to giving our experience in dollars and cents is only that the inquirer may not be entitled to it. If we don't think he is entitled to it, we don't give it to him; but I do say this: that we are the judges as to whether or not we ought to give the information. Personally, I have no objection, if I feel that by so doing I am helping my customer and not violating his confidence in the bank; but I think it depends upon the scope, and whether or not the inquiry *prima facie* establishes the right of the sender, and whether we know that it will be used for his own purposes.

HAROLD W. SCOTT (Pennsylvania Company, Philadelphia): How

far do you think the bank is entitled to give out the actual figures of the customer's statement, considering the sanctity of the relationship between the bank and the customer? Also, and this bears very closely on the other question, just what is the position of the bank when the bank is in, probably, up to its chin and is trying to work out a credit, and it gets an inquiry from the trade—supposing that the customer has a responsible and legitimate need for that particular merchandise in the business and you believe his principles are honest? Just how far should you go in supplying information in those two instances?

MR. MCELVANEY: I think Mr. Tonks has pretty well answered the first question; ordinarily we would give out information regarding the actual figures in a company's statement if we knew that that information was available to the public through other sources. In that case, we know that we are violating no confidence by a discussion of the company's statement.

In connection with your second question, I should like to answer it in two parts. In the first place, I think that a bank is treading on dangerous ground when the subject company is owing the bank substantially and it receives inquiries from the trade and answers them as favorably as possible, with the idea of trying to help the company over the hill, merely to get out of their debt before the crisis comes. I think the bank should be very, very careful about that; it can get into a lot of trouble.

I think it is absolutely unethical for a bank to try to play up the good conditions for the company when it is in bad shape, merely for the purpose of working out its own problem. If

it is generally known, among credit circles as well as banks, that the company is involved, then I think the frank discussion is all right.

MR. SCOTT: I am more concerned with the actual practice from the standpoint of our friend here. He is the one who is going to have the request for credit in the trade. Just how far do you feel that you are at liberty to reveal the situation, not getting this man, who is probably extending a new credit, involved so that he probably will be paid out in three or four months?

Suppose, for instance, that it is a first order, or an old customer, and that there is a gradual slowing up of trade payments, and no figures are published to agencies.

MR. McELVANEY: It all goes back to the same thing. If I know Charlie Knight personally and he writes me the kind of letter that makes me know he is entitled to the information, I will be perfectly frank about it, because I have no desire at all to get my friends into trouble, or anybody else; but, if the inquiry comes in the usual form, I shall be very, very hesitant to give out unfavorable information, not because I mind giving it out but because I want to know where it is going and how it is going to be used.

MR. SCOTT: This is by far the most difficult type of credit question to answer, because there is a responsibility to honest people: you don't want to injure them nor to stand in the way of their chances of regaining their financial position; at the same time you have the responsibility of not misleading some one else. We usually try to make contact with the man who is making the inquiry, and, if that is impossible on account of the distance

—if we can't call him on the telephone and find out the exact circumstances as far as he is concerned—then we try to get our customer into the picture and make it a three-cornered proposition, so that he will not be leading a new creditor into the fold. We frequently have occasion to telephone.

MR. McELVANEY: We do that frequently, too. We usually find that the person at the other end of the line is glad to be called on a proposition like that: it gives him an opportunity to go into more detail than a letter permits.

MR. WALL: We'll say you have an involved customer in Philadelphia and the inquiry comes from a commercial house in Cleveland, about which you know nothing (there may be some doubt in your mind as to the position of that commercial house, although its name may indicate that it is a good one). Wouldn't a possible method be for you to pick out some chap in Cleveland, like Mr. Tonks, whom you know pretty well, and in whose discretion you have considerable confidence, and ask him to handle the matter for you?

MR. SCOTT: No, we haven't done that, although we have had occasion to do similar things—to use an intermediary—but the great difficulty comes when one trade house learns of a situation which is not necessarily bad, but certainly poor. It may disseminate that information and wreck the position of this company and prevent its possibility of recovery.

MR. WALL: Before Mr. Tonks gave that information he would be sure the man he gave it to wouldn't misuse it. He would be protecting the trade situation as you would protect it.

MR. SCOTT: That is why I should like to use the customer. He is the man asking for something. Make him lay his cards on the table and supply something to the new creditor.

WALTER HOWE (First National Bank, Minneapolis): I should like to ask our commercial credit representative present whether he uses the trade association bureaus to any great extent in checking his credits.

MR. KNIGHT: We use them exclusively. That is the proper source from which to obtain your information. If everybody did that and turned in the information from you men, it would be assimilated there and you could be sure it would be used as intended. There are some occasions when I inquire from local associations, especially if the account happens to be a large one and we are known to be the largest creditor.

MR. McELVANEY: Where there is a situation that you feel reasonably sure is involved, do you ever ask your own bank to develop the information regarding it?

MR. KNIGHT: I don't know how it could develop information for me, unless the debtor were a customer of that bank. I had a case like that not long ago. The customer is all right so far, but I knew he was a heavy borrower from this bank, and it was the bank where I carried my account. I took my credit file and went to his office, not for the purpose of finding out about his loan but in order to help him stay in business, because we felt he was expanding too far beyond his capitalization.

MR. McELVANEY: If you were to address an inquiry yourself to the bank where the customer did business, there would be some likelihood of your not getting as full information as

you would get if you went to your own bank and let him, in turn, write the bank, for there is a greater feeling of confidence between the two bankers than between the bank and you.

MR. KNIGHT: I have done that occasionally—had our own bank make the inquiry for the customer wanting the information.

FRANK C. STIVERS (Firestone Park Trust & Savings Bank, Akron): I should like to ask Mr. McElvaney how he handles hotel inquiries.

MR. McELVANEY: Hotels used to have some standing with us, but they don't any more. They have so abused the privilege of making inquiries regarding customers that now we don't answer them at all. If the inquiries concern names we know off-hand, we will write at the bottom of the letter the fact that they are entitled to credit. If the names are not known to us we send the inquiries to the bookkeeper. It is all a matter of establishing credit—of assuring ourselves that the customer has nothing on record to his discredit. We think the bookkeeping department is in a better position to answer those queries than we are, and we don't waste our time on them. We find that hotels send out inquiries needlessly. If a man goes to New York and stays over night we get an inquiry. As I told a friend, Pinkerton's could profitably establish a connection with us if they wanted to follow somebody over the country, because we could tell them day by day where a man was by the hotel inquiries.

THE CHAIRMAN: The gentleman from Akron has evidently got a bale of queries from a hotel that just opened in New York. It sent into our institution on one day forty-two inquiries and one return envelope. In

my opinion, the hotels should belong to the retail credit organizations of the country, acquire most of their information in that manner, and pay for it.

WILLIAM R. WARNER (Fidelity National Bank and Trust Company, Kansas City, Missouri): Do you give definite information over the telephone? Some one calls in, and perhaps you don't know the source of the inquiry.

MR. MCELVANEY: I am very careful in answering credit inquiries over the telephone unless I am absolutely certain to whom I am talking. It is not an uncommon thing in our department to hear this conversation over the telephone: "We are sorry but we don't give out information over the telephone."

We are pestered to death with inquiries from automobile finance companies, for example. If we wanted to, we could put in a direct connection between our office and theirs and keep it busy all day long. We have established this policy: we have brought them into our office and told them that we don't want to be bothered three, four, five, or six times a day. If they will furnish us each morning with the names they want to know about, however, we will answer at one time and get the information back to them that evening.

As to discussing the credit situation over the telephone, we prefer not to do it, even when we know the person at the other end of the line, particularly if it is in connection with a transaction of any size at all. We tell him we would much rather he came to our desk, and thus absolutely eliminate any risk we might be running in discussing the thing over the telephone. You never know at any time who may be listening in.

I had an experience the other day that developed into a three-cornered conversation. As soon as I got the man on the telephone I heard him say, "Get on the other telephone." I told him to come to my office personally and I should be glad to talk it over with him.

THE CHAIRMAN: Put it down as a standing rule never to give any adverse information over the telephone. You are in danger even in giving out favorable information, because it may be for collection purposes.

DONALD FALCONER (Bank of America, San Francisco): I should like to know, Mr. McElvane, how you answer inquiries from the various credit bureaus—not only national bureaus but the shoe and leather bureau, the lumbermen's bureau, and so forth. I should like to know also from commercial credit men how much use the large houses make of such bureaus.

MR. MCELVANEY: If the leather agency or the lumber agency or any other agency has secured any useful information from the First National Bank of Dallas, I should like to have it put on my desk. The inquiries are usually in complicated forms, like the ones I read, and we can't follow them through. All we can say is that the subjects are customers of ours and that our relations are satisfactory—some such perfunctory reply. We find that in many cases the subjects are not our customers at all, and then, as I indicated, we don't bother. We put a rubber stamp on them: "Not our customer. We have no credit information."

MR. KNIGHT: I answer those inquiries in a similar way, but I just write across them, "Satisfactory," or something like that, and put them back

in the mail. There are so many questions on the form that it is almost impossible even for a commercial man to answer. They contain some of the most foolish questions and have no value after they have been answered, if you could answer them intelligently at all.

As to using the National Credit Office, that gets information on commercial paper names, and these other credit bureaus, I don't waste much time on those fellows. I feel that the National Credit Office that is obtaining this information on houses that finance instalment loans and so forth should pay for its information, either through the retail credit association locally or through the local wholesale association.

MR. McELVANEY: Let me add, with reference to the National Credit Office, that it is a pretty well recognized organization. We recognize its inquiries as being legitimate. They write a high type of inquiry and add at the bottom, if they don't know the bank of account, "If you don't know the account, don't go to any expense or trouble." As far as the figures are concerned, where the information is available, we feel perfectly at liberty to give the National Credit Office information on our line and general experience with the account, because it pertains to commercial credit names

and we know that it will be used in legitimate channels.

CHESTER P. STEWART (Commerce Trust Company, Kansas City, Missouri): I should like to ask Mr. McElvaney whether he has ever received an inquiry about some country bank officer or correspondent who is not up to standard, and how he answers that inquiry without reflecting on the country bank correspondent.

MR. McELVANEY: Do you mean an inquiry pertaining to an individual officer?

MR. STEWART: Yes.

MR. McELVANEY: We haven't had a great many inquiries like that. I prefer, in those instances, if we know anything detrimental, not to put it in writing. We are very, very careful to whom we talk about bank officers. You know, banks depend on public confidence to stay in business, and we are especially careful concerning inquiries about banks or bank officers. If we get an inquiry from some one whom we don't know concerning an officer of our correspondent bank, we are very, very guarded in our reply to it, because we fully realize that there is a possibility of injuring the bank. I should prefer in those instances to suggest that they communicate with our Robert Morris Associates in that town, or with some of our other friends there.

Deposit Functions

Bankers' Deposits and Facilities of Reserve City Banks

By C. B. ANDERSON

TREASURER OF THE UNION TRUST COMPANY, CLEVELAND, OHIO

Address before the Denver Departmental Conference

There was originally considerable objection to the Federal Reserve Act. Opposition came from reserve city bankers. They felt that, with reserves centered in the Federal Reserve, their "country bank" balances would be reduced. The country banker was as strongly opposed, but for a different reason. Considerable income was derived from the exchange which he charged when remitting for his own customers' checks. Now the correspondent bank continues to do collection business side by side with the Federal Reserve banks, while the country banker, for the most part, has made up, in other directions, his loss of exchange. Under present-day conditions, there is economic need for the correspondent bank so located that it can collect, without delay, a certain territory. It necessarily follows that there cannot be service on the one side without compensation for it on the other. A worth-while account, then, will show balances to cover all those items of expense, and something more, upon which the correspondent bank can earn the profits which economically justify its existence.

THE European, with his restricted trade territory, surrounded by tariff walls, finds much to marvel at in our wide distribution of goods, so quickly and easily effected. During the year 1929 the railroads of the United States moved 52,000,000 cars of revenue freight.

Raw materials move to the cities, are fabricated, and move back again into consumption. Agricultural products move from the farms to feed workers in the cities. We do all of this without customs barriers or problems of domestic exchange. Our principal cities not only have a large volume of business, each with the others, but all of them likewise act as distributing centers for adjacent territory.

In this scheme of distribution, through manufacturer, wholesaler, and retailer, we finally reach the ultimate consumer. All along the line, financial obligations have arisen which must be satisfied.

It is estimated that not more than 10% of all such transactions are paid for with actual money. This is relatively unimportant in comparison with the 90% which is satisfied through another medium, that circulates to all intents and purposes as freely as money and answers its functions admirably. I refer to the check, which may be defined as "a bill of exchange drawn on a bank and payable on demand."

The qualities which make the check an ideal form of currency are its short life, the ease with which its

use expands and contracts with the needs of business, and the fact that while in transit this check is a "frozen asset." It follows, necessarily, that presentation for payment should be made at the earliest possible moment.

How is this transfer of money effected between the drawer and the holder of the check?

It is not necessary in this group of people to discuss the details of transit work. Let us rather consider the problem in its broader aspects by contrasting two periods, one before and the other after the advent of the Federal Reserve System.

OPERATION UNDER NATIONAL BANK ACT

Under the National Bank Act, national banks fell into two groups: the one, comprising reserve cities, about fifty in number, three of which (New York, Chicago, and St. Louis) were known as "central reserve" cities; the second, comprising all other national banks. These latter were called "country banks."

"Country banks" could keep three-fifths of their legal reserves in the form of credits at reserve city banks, and reserve city banks could keep one-half of their reserves in central reserve city banks. The various states had similar reserve requirements for banks operating under the state.

If each bank had undertaken to collect directly checks deposited over the counter, it would have meant that payment for them would have had to be made by shipping currency. Obviously, if that method of settlement had been followed, checks would never have achieved their present popularity as a means of satisfying obligations at a distance.

However, a bank could, and did, build up reserves in the form of credits at reserve city banks, by sending to them for collection such out of town checks as were received over the counter.

Here, then, is the genesis of what has come to be known as the "correspondent bank."

Under the National Bank Act, the correspondent bank at a reserve city, so far as the collection of checks was concerned, filled the needs of both national and state banks, perhaps not very well, according to present-day standards, but quite satisfactorily for a generation not in the habit of figuring "float" and "realized balances," and accustomed to paying exchange charges.

Each correspondent bank, over a period of years, had built up a list of points at which it could collect at par. All kinds of indirect routings were used to avoid exchange charges, and a transit sorter used the collecting bank which was able to get a par remittance.

It was a question, not of getting the check collected quickly, but rather of getting it collected without exchange cost. The best (or worst) example of indirect routing that I have seen is given in W. H. Kniffin's book, *The Practical Work of a Bank*. A check on Sag Harbor, New York, was deposited in Hoboken, New Jersey. Before it reached the paying bank, the check had traveled 1,500 miles and had been handled by nine different banks, one of which was in Boston and another in Tonawanda, New York.

UNDER FEDERAL RESERVE ACT

Some one has said that "prophe-

syng is the most gratuitous form of human folly." If you wish to be convinced of this, read, in H. Parker Willis's book, *The Federal Reserve System*, the discussion of events leading up to the passage of the Act. The history of the System, with its many years of useful service behind it, must confound utterly some of its early critics.

Opposition came from reserve city bankers. They felt that, with reserves centered in the Federal Reserve, their "country bank" balances would be reduced. The country banker was as strongly opposed, but for a different reason. Considerable income was derived from the exchange which he charged when remitting for his own customers' checks.

In support of some of the following generalizations, I shall refer you to *Bankers' Balances*, by Leonard L. Watkins, Assistant Professor of Economics, University of Michigan. This book is an exhaustive study of the subject.

In the period from 1902 to 1914, it was the practice to carry reserves greatly in excess of legal requirements. Reserve city banks exceeded this reserve requirement by from 15% to 25%, and country banks by an amount little short of 100%. Funds of both classes of banks carried with non-reserve agents alone exceeded the reserve element.

Subscriptions to Federal Reserve bank stock and the shifting of strictly reserve balances might be expected to reduce bankers' deposits. But, under the new order of things, there would still be funds, in the nature of secondary reserves, at least part of which correspondent banks might expect to have carried with them. The sharp reduction in reserve require-

ments at the Federal Reserve bank (an example which was followed by the states generally) would create a large additional volume of funds, on the basis of which banks could expand loans, increase investments, or make deposits with correspondents.

A compilation made by Mr. Watkins shows that bankers' deposits did not shrink; on the contrary, they have stood at a higher level since the establishment of the Federal Reserve System, than before.

We find that, as usual, no situation is ever quite so bad as it is painted. The correspondent bank continues to do collection business side by side with the Federal Reserve banks, while the country banker, for the most part, has made up, in other directions, his loss of exchange.

The Act requires that member bank reserves must be carried at the Federal Reserve banks. It was apparent to the framers of the Act that the reserve should be something more than a dead fund held to take care of possible emergencies. To insure a regular flow of business to and from the member banks, even in a period of slack rediscounting, it was provided that the Federal Reserve banks should undertake as one of their functions the collection of checks for member banks. This, it seems to me, made an ideal tie-in of the member and the Federal Reserve banks.

FEDERAL COLLECTING FACILITIES

While member bank reserves must be carried at the Federal, the use of its collecting facilities is not mandatory. As you know, reserve credit is deferred for the number of days it takes to obtain actual payment for

checks. These must be listed in accordance with their availability dates, which means that seven or eight separate cash letters must be written. This is true where the member bank uses its own Federal Reserve bank.

If the collecting facilities of all the Federal Reserve banks are used, the time in transit of checks is reduced, but this means additional sorting, with more cash letters to be written. The larger member banks, with their heavy volume of checks, meet these conditions easily, and use the Federal's facilities as a convenient, economical means of building up reserve balances. The smaller member banks, however, find it difficult to meet this requirement.

THE NEED FOR CORRESPONDENT BANKS

It is my contention that, under present-day conditions, there is economic need for the correspondent bank so located that it can collect, without delay, a certain territory.

To one who would say that this is merely a duplication of existing facilities of the Federal Reserve, I would point out that all banks are not members; that there are a great number of banks which do not remit at par, and whose checks cannot, therefore, be collected through the Federal Reserve; and that there are numerous items which are handled by most banks as cash but which will be accepted by the Federal only as collections.

Then, we have the member banks which prefer to write but one cash letter and which build up their reserve at the Federal Reserve through transfers from the correspondent bank of realized balances.

There is also the member bank which, while using the Federal Reserve's collecting facilities to build up reserves, will transfer any excess to a correspondent, in order to draw interest. If all this be true, we have no duplication of services, but rather a supplementary service to that which the Federal Reserve banks render.

To say that the Federal Reserve banks do not do, or perhaps do differently, many of the things a correspondent bank does for its customers, does not imply criticism. I will admit frankly, though, that the correspondent bank has probably capitalized such differences as do exist.

Take the rediscount privilege at the Federal Reserve, for example: the law clearly limits it to "notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes." The Federal Reserve banks must have in their files, or be furnished with, a recent statement of the makers of the paper securing the note. There is nothing particularly burdensome in these requirements, and the large city banks meet them easily.

Many country bank members have no eligible paper and meet more easily the simpler requirements of their correspondents that the note be secured by marketable bonds or by customers' paper, in, say, a two-for-one ratio.

An important point to mention here is that the correspondent bank (even though it may be necessary to rediscount at the Federal Reserve) is committed to take care of its country bank customers in their periods of seasonal borrowings.

As between the city correspondent and the country bank, such differences in operation as exist will be of

magnitude rather than of kind. Naturally, there is a community of interest, and this has often been made closer through years of personal as well as business association between the operating officials. Services which at first the country banker may have asked for casually have now become matters of routine.

The supplying of credit information, the preparation of income tax statements, the safekeeping of securities, the analyzing of security lists—all of these, and more, the correspondent holds itself in readiness to do.

I said earlier that, in my opinion, there is economic need for the correspondent bank. If you grant this, it necessarily follows that there cannot be service on the one side without compensation for it on the other. Granted these premises, what may the correspondent bank expect from its customers?

The balance which the country bank carries with its correspondent should be considered as a tool of trade. It is being built up consistently with miscellaneous cash items sent for collection. Inasmuch as these are often spread over a wide territory, we have involved a factor which must be considered in connection with the balance appearing on the ledger.

The analysis department will figure the transit or "float" on incoming cash letters to determine the availability of these funds. The ledger balance, then, must be large enough to offset this float. It must, furthermore, be large enough to cover a proportionate share of the work in such departments as transit, collection, bookkeeping, and clearance.

If a bank is using some of the specialized departments, or sends through

business on which an exchange charge is paid, then there must be a further adjustment of balances upward.

A worth-while account, then, will show balances to cover all these items of expense, and something more, upon which the correspondent bank can earn the profits which economically justify its existence.

All this presupposes not only careful solicitation in getting bank business on the books, but equally careful administration of the account afterward to see that it remains on a profitable basis.

Inasmuch as this business can be made profitable, it is reasonable to expect that correspondent banks will continue to solicit it.

We might fairly ask whether there is not a better way of handling it. The method used, however, is probably as good as any which might be devised, under present conditions. The country bank, through its city correspondent, has the benefit of wide collecting facilities and access to all the credit it might reasonably be expected to use.

THE FUTURE OF THE CORRESPONDENT BANK

While there is no likelihood of its happening soon, it is entirely possible that the Federal Reserve will in time take over all collection work.

A great problem is to get par remittances from banks in certain sections of the country.

A movement initiated in Boston last winter, which looks toward a more liberal disbursement to stockholders of Federal Reserve bank earnings, shows signs of spreading. Possibly an increased return on the

investment might induce more banks to come into the System. The remaining banks, through a process of education, might be induced to forego the exchange charge. A solution of this problem would have to be found.

Experience has shown that member banks carry little, if any, more than their required reserve at the Federal Reserve. If the practice of carrying balances greatly in excess of reserve requirements continues, then this excess will go to banks as bankers' balances. When, and if, collection work is centered in the Federal Reserve, the correspondent banks would have "clean" balances and lower operating costs. It is likely that the resulting profit would be just as satisfactory as that which they now receive.

The transition would be a gradual one, however. The capably managed correspondent bank, with ample time to study the situation, may be expected to face with equanimity, the new conditions when they come.

Discussion

THE CHAIRMAN: It seems to me we might profitably discuss what services are required of city banks by their country bank correspondents that are either duplicated under the Federal Reserve System or that are unnecessary or perhaps beyond the scope of a correspondent bank relationship; and, on the other hand, what services are provided by the city correspondents for their country correspondents that are unnecessary, that are not adequate, or that perhaps are attempting to compete unnecessarily with the Federal Reserve System.

The whole question of routing and

sorting transit checks has been suggested for discussion, and the old problem of exchange and power collection facilities, as well as the one which is receiving a great deal of attention today—when is an account of a correspondent bank profitable or unprofitable, and what is a reasonable profit on a bank account?

MR. OLSON (Colorado National Bank, Denver): I should like to know what the usual time for returns is. For instance, when an item is sent to a city correspondent and returned "non-received" in the usual number of days, what is the usual time taken for the correspondent to notify the bank for returns?

MR. ANDERSON: That all depends, of course, on where the item is payable and through what source it was sent. The Federal Reserve schedule is the one we usually work on but that takes you only one way on your item. You have to figure the item coming back from the other end, and it usually takes just as long as the schedule going. You might have to allow a day for protest. There are a good many banks that hold their protest items over, and their protests are returned the following morning. Then of course there are mail connections that are missed, and it is really a hard thing to say just how long you hold your funds before you pay out against them. You have to take all those things into consideration. Of course, practically all banks have arrangements whereby they expect to wire on all items either over \$500 or over \$1,000 if the items are not paid; then you should get the notice on the same day the item is turned down and refused, although it might be at the end of the day and you might not get it until the next day.

THE CHAIRMAN: You people in the East should remember also that there is a distance in time as you go West, and when you do not get a wire at the close of business in New York, you should remember that we are still doing business on the Coast.

MARION S. BURDETT (Walker Brothers Bankers, Salt Lake City): We have a rather difficult question. We are located eighty miles from the state line of Wyoming. In order to clear all items we have to send to the Federal Reserve bank which in turn sends to Omaha. All the banks in Wyoming are a good deal smaller than our own bank and naturally we do not have correspondent facilities in the entire state of Wyoming. I should like to know what would be the best thing to do. Suppose you had a bill of lading amounting to a great deal, payable in Wyoming, and that you did not feel free to send it to one of the smaller banks in Wyoming on account of its large size.

MR. ANDERSON: Your trouble is the question of geographical location and being close to the line of another Federal Reserve district.

I should say that with any bill of lading item your best method of handling it would be to send it direct to the town it is drawn on. You might have to pay a little exchange on it, but that is the simplest way, if you are that close to Wyoming. With our collecting facilities, of course, we expect banks out West, some distance from us, to send us their bills of lading because we have a great many connections; but you would be in a slightly different position from ours.

MR. BURDETT: The banks out West, especially in Wyoming, are very small. If one of the banks failed in Wyoming while that bill of

lading was in transit, I believe it would be the responsibility of the bank.

MR. ANDERSON: Of course you have to consider that. If there is more than one bank in a town you want to pick the strongest bank in that town. I do not know whether Wyoming has the law that a bank draft in payment of such an item would be a preferred claim or not. They have that in a great many states and it is working more and more through the United States; I imagine that some day it will be universal.

THE CHAIRMAN: Mr. Canfield, you are familiar with the Wyoming law. Can you answer?

CHARLES I. CANFIELD (First Security Corporation, Ogden, Utah): I do not think that any sending bank is liable to its customer for the collection of these items if due diligence is used. Of course, if you did not take the necessary precautions and it was proved that you did not, I have an idea it would depend entirely upon the court when it was presented. We have had many adverse decisions in Wyoming, Idaho, and Montana, and in several of the eastern states. But I think the matter of due diligence is primarily the factor considered.

J. E. OLSON (Federal Reserve Bank, Denver): As far as Wyoming is concerned, it has a preference law and that law is up for decision in the Supreme Court at the present time on one of our cases.

RONALD T. SYMMS (Federal Reserve Bank, Seattle): Mr. Anderson mentioned in his paper that it was quite possible and more than probable that the Federal Reserve banks would handle in time all transit and collection items. However,

it has been noted in our district that the Federal Reserve transit departments are handling fewer items than formerly, because of direct sending within the district by group banks; it would be interesting to know what observations have been made in regard to this point in other Federal Reserve districts.

THE CHAIRMAN: Have you any idea or theory as to the reasons?

MR. SYMMS: No, except that the laws of the State of Washington prohibit branch banking, but we do have the chain system of banking, and I thought a great deal of it might be caused by the fact that the parent banks work to keep in closer touch with their subsidiary banks throughout the district; there may be some basis for direct routing for that reason. Other than that I can see no reason why the Federal Reserve System itself should not be used.

DON CROULEY (Northwestern National Bank, Minneapolis): The Northwestern Bank is considered the parent bank of the Northwest Bancorporation, and as far as the routing of our items is concerned, there has been no change. However, there is one thing about the Federal Reserve System that makes it hard for the city bank, and that is that they close off items early in the day and it is impossible for us to get our items to them so that they can be handled the same day. It necessitates a great deal of direct routing.

MR. ANDERSON: What time do they close on your items?

MR. CROULEY: In Minneapolis we have to close at two o'clock.

MR. ANDERSON: Do you make

any distinction between large and small accounts?

MR. CROULEY: No.

MR. ANDERSON: In Cleveland we take small items up to two o'clock and items over a thousand until three.

MR. CROULEY: Practically all city depositors' items are taken in in the afternoon, and generally in large cities those items amount to a considerable amount of money; it means the city bank is taking one extra day for handling through the Federal Reserve bank. For that reason most of the city banks are making arrangements to collect those items so that they can get them out and have them in transit that night unless held over to the following day.

CHARLES HEMMINGSEN (First Seattle Dexter Horton National Bank, Seattle): I should like to say in regard to that, that the Federal Reserve bank time is the deciding factor. In Seattle we close on small items at three o'clock and on large at four. We find that a great number of large items come in after that and we find that we save time by direct routing to each bank.

THE CHAIRMAN: Do I understand that you direct-route all your items or do you use the Federal Reserve bank up to closing time?

MR. CROULEY: No, we direct-route wherever we have a correspondent. There are a number that we do not carry accounts with and we send those items through the Federal Reserve bank. But I should say that in about seventy-five per cent of the big Washington towns we have correspondents and we send directly to them.

Federal Reserve Facilities for Member Banks

By J. E. OLSON

MANAGING DIRECTOR OF THE DENVER BRANCH, FEDERAL RESERVE BANK OF KANSAS CITY, DENVER, COLORADO

Address before the Denver Departmental Conference

The Federal Reserve Bank of Kansas City finds that its member banks are often unaware of the services available to them. Among the facilities offered are:

1. Safekeeping facilities for bearer bonds of any character
2. The shipment of currency and coin to and from member banks without any charge for either postage or insurance
3. Prompt collection of checks
4. The sending of items payable in other Federal Reserve districts direct to the Federal Reserve bank or branch in the district in which the bank upon which the items are drawn is located
5. The handling of non-cash collections in about the same manner as the commercial banks handle them
6. The basing of loans on the borrowing needs of the members and the character of the paper offered.

Mr. Olson feels that the payment of interest would lessen the assurance that the Federal Reserve bank would be able to function properly during times of financial stress.

THE Federal Reserve Bank of Kansas City has what we are pleased to term "member bank relations," men whose duty it is to call on the member banks in the tenth district with a view to obtaining information as to whether the services rendered to the members are satisfactory and wherein they can be improved upon. In reading the reports submitted by these men, the thing that impresses me most is the lack of information on the part of members of the services which are available to them through the Federal Reserve Bank devised for their benefit and convenience.

The Federal Reserve Act was passed in 1914 for a very definite

purpose, and, while the banks brought into being by that act have been operating for nearly twenty years, many members apparently have no conception of the functions performed or services rendered, this in spite of the fact that circulars are forwarded to each member explaining in detail the various functions performed and services offered.

SAFEKEEPING FACILITIES FOR BONDS

For instance, about ten years ago the Federal Reserve Bank of Kansas City offered its members safekeeping facilities for government bonds of all issues owned by the

member bank. A few years later the service was broadened and in addition to government bonds we informed members that we would accept bearer bonds of any character. Separate receipts are issued to the depositing member for each series of bonds which are non-negotiable and non-assignable. Coupons are detached by us as they mature, and, when collected, proceeds are placed to the credit of the member under advice. The only charge made is for postage and insurance when instructions are received to ship the securities. Securities in our custody may be used by the depositing member for collateral purposes in any department of the bank, upon written request, without return of the receipt, but no securities will be released until the officially signed receipt is returned. Since our representatives have been advising our members of this and other services the work has been steadily increasing.

COLLECTIONS: CURRENCY, COIN, CHECKS

We will now pass on to the currency and coin service. Currency and coin are shipped to member banks on request without any charge for either postage or insurance, and likewise we absorb all charges on incoming shipments.

All currency received is sorted as to fit and unfit for further circulation, in accordance with standards set by the Treasury Department, and all unfit currency is retired from circulation.

The check collection function has been in my opinion of much benefit to members, as the system in use at the Federal Reserve bank insures

prompt collections of all items received when the drawee bank has agreed to remit at par without undue delay. Since all member banks are furnished with information as to the time required to collect all items, and they know how long it will take their letter to reach the Federal Reserve bank of their district, they know the date as of which the total of their letter will be available for reserve. Credits entered as immediately available are only advised by entry on daily transcript of account. Notices covering receipt of deferred availability letters and advising of maturity are mailed on date of receipt.

Under certain conditions, when permission has been granted by the Federal Reserve bank, member banks may send items payable in other Federal Reserve districts direct to the Federal Reserve bank or branch in the district in which the bank upon which the items are drawn is located. This practice very often makes it possible for the members availing themselves of the privilege to receive credit at least a day sooner than would be the case were items routed to the Federal Reserve bank or branch of their own district.

Non-cash collections are handled in about the same manner as the commercial banks handle them. That is, they are registered when received, and, if drawn on a firm, corporation, or individual located in the city where the Federal Reserve bank is located, are presented by messenger. If drawn on points outside of the city they are sent to local banks for collection, unless drawn on points outside of the district, when they are forwarded to the Federal Reserve bank of the district in which the point on which drawn is located.

FUNDS BY WIRE

Another free service which I believe has become very popular with member banks is the transfer of funds by wire. Through the operation of the private leased wire system and the Gold Settlement Fund at Washington, we are able to handle this business on very short notice, and, when request is received within the hours specified by the several Federal Reserve banks for the handling of such items, the transfers are effected with no loss in the way of float.

The balance which members carry at their Federal Reserve bank is regulated by the statute, and the per cent of demand deposits required to be carried is in accordance with the location of the member; that is, whether it is located in a reserve city, a central reserve city, or in neither. The privilege of using the services offered does not depend on the size of the balance, but solely on the fact that the bank is a member of the system.

INTEREST NOT ADVISABLE

At times the question of interest is brought up, but to my mind, were that policy inaugurated, the member banks would not have the assurance that their Federal Reserve bank would be able to function properly during times of financial stress, if, in order to make sufficient money to pay interest during normal times, they were forced to seek investments in the open market to make sufficient money to cover interest payments. An illustration of the point raised would be to compare the system to a fire department, which, like the system, was inaugurated to handle emergencies. It would not be safe to have the mem-

bers of the fire department employed in other work until an alarm came into the station, as it would take too long for them to get started for the fire; so with the Federal Reserve System. It would be difficult for a Reserve bank to reduce its paper which had been bought in the open market sufficiently to be of much use to member banks for discounting purposes should an emergency arise.

While I have left the discount function until the last, I think it one of the most important, but, since that was one of the main reasons for the enactment of the Federal Reserve Act, its operation is familiar to most of you, and I therefore will not take much of your time for its discussion, save to say that its loans are based on the borrowing needs of the members and the character of the paper offered. The Federal Reserve banks, not being organized for profit-making purposes, are governed solely by the rule laid down by the Act, which provides that they shall extend such advances "as may be safely and reasonably made, with due regard for the claims and demands of other member banks."

Discussion

HUGO TENNER (Atlas National Bank, Cincinnati): Some of the towns in the Cleveland district are just as close to Cincinnati as they are to Cleveland, and it takes an extra day in mailing transit items to Cleveland. Cleveland has to mail them back to these other towns and they remit back to Cleveland. I do not see why our Cincinnati branch could not handle those items for us.

MR. OLSON: The only answer I can give to that is that there are sev-

eral different types of branches of Federal Reserve banks. In the tenth district the branches perform all functions with the exception of distributions. The Denver and Omaha branches perform everything. The Oklahoma City branch, while it handles rediscounts, sends them to the parent office, and all the books are carried at the parent office. In the Cleveland district, I understand—I am not sure, probably some one from Cleveland can answer more fully—that none of the branches are full fledged branches. They perform some of the functions, for instance; currency functions principally. All other functions are carried down at the Cleveland office. I am not sure about transit. It seems to me they send the transit items to Cincinnati and that they handle them there. I believe that Detroit just handles a few items just outside of Detroit. But we handle all items in Colorado and northern New Mexico. Omaha handles Nebraska and Wyoming. Kansas City handles Kansas and the eastern portion of Missouri, and those banks preferring to remit to Kansas City and Oklahoma City are privileged to do so. Because of the fact that so many Oklahoma banks carry their correspondent balances in Kansas City they all have the right to remit on either the Kansas City bank or the Oklahoma City bank.

THE CHAIRMAN: Mr. Olson, may I ask a question that follows in that connection? You said that your Denver branch was accustomed, in view of geographical location, to route into Wyoming, which was in another branch zone, for your own member banks in this zone, and I wondered if that was discretionary with your bank or your Federal Reserve bank

in Kansas City, and whether it was discretionary in this case with the Cleveland bank as to whether it could or could not route into another branch or bank zone.

MR. OLSON: There are a number of small places in Wyoming, some very remote from railroads. We had an item of a large packing company which a man deposited with one of our Denver banks, which they sent to Omaha. It took something like ten or twelve days to get a return. The company complained to the Board at Washington and they asked us if we could not work out some scheme to handle it differently. We made the suggestion that as far as Denver was concerned, or the Colorado banks, we send direct, and we worked out a method with the Omaha branch that we have no trouble with. I believe it is discretionary with the head office as to the districts or zones for their branches, but beyond that, the arrangement must come through the Board.

THE CHAIRMAN: In meeting the problem presented in the Cincinnati zone, should the Cincinnati bank appeal to the Federal Reserve Board at Washington rather than to the Federal Reserve Bank of Cleveland?

MR. OLSON: It is hard to answer that because there is too much involved.

CHARLES B. ANDERSON: (The Union Trust Company, Cleveland): I think I can answer that. The Cincinnati branch has a zone which takes in the southern part of Ohio and the eastern part of Kentucky. That is in our district. The Federal Reserve Bank of Cleveland will take items on all the larger towns in that district, in the Cincinnati district, and send them direct to those towns for remittance in-

stead of sending to Cincinnati and re-routing from there. It really puts them on a two-day basis out of Cleveland. If the head office can do that for the Cleveland bank in that part of the country, I do not see why the Cincinnati branch cannot pick up the larger towns in the northern part of the state and send those items direct instead of to Cleveland and from there on. I think it is a case of taking it up with the Federal Reserve Bank of Cleveland.

MR. TENNER: It does make a few exceptions on four or five of the larger towns.

OWEN E. THOMAS (Federal Reserve Bank, Minneapolis): Those branches that settle direct we can credit and charge on our books. Of course Cincinnati does not settle direct; it settles with the head office, and our Cincinnati items go direct to Cleveland. When we have Denver items, we send direct to Denver. Omaha goes direct. Any of the branches that send direct get the items direct.

It seems that the problem there for Cincinnati is to get the direct settlement privilege through the gold settlement fund.

THE CHAIRMAN: It seems to me that the Federal Reserve System is much more flexible, much less arbitrary than most of us seem to think it is; it is my observation that bankers generally have not realized that or that there is a Federal Reserve Board in Washington which seems to be quite receptive to suggestions that might be made for improvement in facilities. But bankers generally seem to feel that they can take only circulation from the Federal Reserve bank and that they must either comply or not comply with its regulations—that

there is no court of appeal. Just at the moment the matter of the Federal Reserve bank requirements is under discussion with the Federal Reserve Board by a committee of the reserve city bankers. All of you know the problem of a large city bank as to settlement days. They have to make two guesses in advance. They have to guess first what the Federal Reserve bank requirement will probably be at the close of business on that day; in other words, what their deposit liabilities will probably be. Then they have to make a second guess and that is as to how much money they will probably have in their Federal Reserve bank account at the end of that day of business. The suggestion came that the Federal Reserve banks permit the Federal Reserve city banks to settle their reserves at the close of business, basing the settlement on the deposit liability at the beginning of the day's business. We understand that the Federal Reserve Board is quite amenable to the idea. That is one of the subjects up for discussion. It has been held up only because there are perhaps more important things being considered.

MR. ANDERSON: I should like to ask a question in regard to the matter of postage. Does your branch pay the postage for any of your correspondent banks? In other words, do the banks in Denver deliver their transit letters to your office? Do you pay the postage on them?

MR. OLSON: Yes.

MR. ANDERSON: There seem to be a number of branches that do that but not all of them. I wish they would do it in Cleveland.

MR. OLSON: We find it saves us time. It does not increase our postage one bit. They will bring the let-

ter to us and we will cross it and see that it is forwarded. Then if there is any delay on account of mail schedules or anything else the bank is not penalized because of that delay. It is still the same transit item. That is not the case with air mail.

JAMES C. CRASE (American Trust Company, San Francisco): One question, Mr. Olson. In connection with your currency shipments, I believe you said the currency comes in to you and you sort it. Is that right?

MR. OLSON: Yes.

MR. CRASE: In sending that out to the various banks, do you have many cases of overages or shortages?

MR. OLSON: Naturally, we are not perfect. We do have a few errors that creep in occasionally, but I would not say there are many.

MR. CRASE: Is the sorting all done by hand or by machines?

MR. OLSON: We got the machines only a short time ago and are not using them yet.

MR. CRASE: You mentioned a while ago that you paid the cost of the shipments out and the shipments in. Does that consist only of the standard packages of currency, or all kinds, or do you have to ship out standards of thousands, and so forth, on different denominations? Are there any broken packages at all?

MR. OLSON: Of course we want it sorted as close as possible to hundred dollar bills to the package, but if there is anything over, that is all right.

MR. CRASE: Suppose another bank sends you a hundred dollars in silver. Would you pay the postage on that silver?

MR. OLSON: We do.

MR. CRASE: It does not have to be in thousands of dollars?

MR. OLSON: No, because some of the smaller banks through our territory would have a hard time accumulating a thousand dollars in nickels.

Transit and Collection Problems of a Group or Branch Banking System

By C. I. CANFIELD

GENERAL AUDITOR OF THE FIRST SECURITY CORPORATION, OGDEN, UTAH

Address before the Denver Departmental Conference

Mr. Canfield, in discussing the numerous and varied transit and collection problems of a group or branch banking organization, treats in detail the following items:

1. Interbank transactions
2. Other transit items
3. Collection items
4. Special items
5. Returned items
6. Adjustments
7. Drafts
8. Supplies.

Mr. Canfield is certain that the systems outlined operate for efficiency, economy, and greater profits, as they are easily understood, easily operated, and designed to prevent duplication of labor.

A BANK'S first obligation is to its depositors; its second, to its stockholders; and if it has other duties to the community in which it operates, they are subordinate to those mentioned. It is therefore necessary that, above all other things, a bank maintain solvency; if it does not do this, and in addition create a fair return to its stockholders on the money they have invested, it cannot justify its existence. What I wish particularly to emphasize is that the success of any bank is measured entirely by its ability to invest judiciously the funds entrusted to it so that it will maintain unquestioned solvency as far as its depositors are concerned, and yet produce a maximum return for its

stockholders. An efficiently operated transit and collection department adds materially to the service a bank renders its patrons, is instrumental in securing new business, and yields additional profits for the bank; while this department, if inefficient and carelessly operated, might jeopardize the funds of the bank's customers, and create losses to the bank, both in money and in the time of executive officers.

SUMMARY OF TRANSIT AND COLLECTION SYSTEMS

In discussing the numerous and varied transit and collection problems of a group or branch banking organization, I believe that a brief

summary of the systems employed by some of these institutions will give you a picture of such problems and the methods used to meet them. I will discuss only those systems which I believe offer the greatest economy and efficiency. Some group organizations are operating each bank owned or controlled as an independent unit, without regard to other banks belonging to the same group. Such a group is in the class of an independent bank in so far as operations and systems are concerned.

The systems which will be explained, I believe, not only reduce the cost of labor by eliminating the rehandling of items by other institutions, and decrease waste in supplies, postage, and loss of interest, but also speed up presentation and generally increase the efficiency of the bank.

Let me first give you a general picture of the relationship of a branch or member bank to the parent bank, so far as the transit and collection departments are concerned. All branch or member banks have but one "due from" bank account, which, in the case of a branch bank, is called the "internal clearing" or "settlement" account. The account is carried with the parent bank and permits the mobilization of reserves, allowing the parent bank to increase earnings for the system by the judicious investment of a greater amount than would otherwise be possible, were each bank to carry its own correspondent bank accounts.

Each branch or member bank has the same privileges, and has access to the same correspondent banks as does the parent institution, but all transactions are handled for them over the parent bank's account.

I will discuss my subject in the following order: interbank transactions; other transit items; collection items; special items; returned items; adjustments; drafts; and supplies. You may infer, from the number of topics, that I intend to cover the entire internal operation of a bank; such, however, is not the case; but the importance of the transit and collection departments and their close relationship to other departments should not be underestimated.

INTERBANK TRANSACTIONS

Let us take up the first topic, that of interbank transactions. By this we mean the exchange of items and the handling of transactions between branches or members of the same organization, and the manner in which settlements are made. You can readily see that it is in the interest of economy to have branches or members exchange items directly among themselves, thus saving rerouting by the parent bank, with the additional cost of rehandling and the necessary loss of time in presentation. To illustrate: Assume that the parent bank is in Omaha and that there are members at Cheyenne, Denver, and other points. Cheyenne wishes to present its items on Denver as quickly as possible and at the same time receive collected funds, which will create earnings without unnecessary delay.

The method which is most commonly used and which offers the least amount of labor and trouble is as follows: Cheyenne would forward its remittance letter to the member bank in Denver, noting at the bottom of the letter "For our credit at Omaha." At the time the letter is sent to Den-

ver, Cheyenne makes a special form debit against Denver for the total amount of the remittance letter sent. This debit ticket is then treated in the same manner as a draft drawn by Denver on Omaha in favor of Cheyenne.

Under such a system Cheyenne would accumulate several of these debits against various member banks during the day's business. At the close of the day, Cheyenne would list all of these debits in a separate remittance letter and send to Omaha, charging Omaha with the total amount of the letter, thus reducing the amount of work required in reconciling its account with Omaha. Upon receipt of the remittance letter from Cheyenne, Omaha would credit the total amount of the letter to Cheyenne's account, and the debit tickets made by Cheyenne and contained in the remittance letter would constitute Omaha's general ledger debits against the various banks to which Cheyenne had sent remittance letters. Upon receipt of Cheyenne's remittance letter, Denver credits its account with Omaha, always for the total of the letter, regardless of whether the letter contains items which are uncollectable or whether the total is correct. Denver advises Cheyenne only; it is unnecessary to advise Omaha, for the reason that Omaha has already been advised by Cheyenne through the use of the special debit ticket.

CHECKING AND TRACING OF REMITTANCE LETTERS

In connection with the above transaction several questions are naturally raised, such as these: How does Omaha know the remittance was for-

warded? What if it were lost in transit? What does Denver do with items it cannot collect? How are errors adjusted? How does Denver know that correct charges are being made against its account? Could not charges be made without Denver's receiving the items? Would it be possible for the debit to reach Omaha before the items reached Denver? The system in use answers most of these questions. Each bank receives a daily transcript of its account with Omaha, which acts not only as an advice of credits and charges but also as a statement of account. Each member is required to check this statement against its books the day it is received, and to report any outstanding item to Omaha within at least two days from the date advice of charge or credit is received. It then becomes Omaha's duty immediately to trace the item and clear the records. In the case of a lost remittance, it may require the reversing of the original entry, so that the originating bank would be charged and the receiving bank credited.

From this explanation you can readily see that a branch or a member bank, within a day or two, has knowledge of all charges or credits made against its account by the parent bank. Remittance letters which might become lost would be discovered and reported, as a rule more quickly than under the old system, because a member bank will not allow its account to be charged and thus lose interest on balances without making some effort toward adjustment.

To enforce the prompt checking of these statements, a rule is made that unless errors or exceptions are re-

ported within two days after receipt of daily statement, the charge stands until it can be investigated, which means the loss of interest on the amount, and, in cases of returned items of small amount, may mean an actual loss of the principal involved. Credits are reversed and interest adjusted, so that the bank does not get the benefit of the earning.

Perhaps you think this rule severe, but it must be remembered that delays and carelessness are very expensive, and some one must absorb this expense; then why not the one responsible for reporting such exceptions? This serves also as an additional incentive to keep the work of the bank up to date.

In connection with items sent by one bank to another, where the debit would reach the parent bank before the items reached the member to which they were sent, the charges are deferred until the items have time to arrive, at which time the parent bank adjusts. This is all worked out on schedule, and the parent bank makes the adjustment. As a rule, these apparent inequities adjust themselves automatically.

The procedure outlined covers only remittance letters. Other transactions are handled by advice among members. For instance, should one member bank receive funds to be transmitted to another member, the bank receiving the funds would credit the parent bank and advise the member concerned. Upon receipt of the advice of credit, the member would make a special debit against the bank receiving the funds, and forward such debit to the parent bank in the regular remittance letter containing debits. Should one member have a charge against another member, it makes a

special debit against that bank and forwards such debit in its special remittance containing debits to the parent bank, advising the member bank, which, in turn, credits the parent bank for the amount involved.

OTHER TRANSIT ITEMS

Let us now take up the handling of other transit items, or those items drawn on banks at points where no branch or member is located. The procedure is somewhat different. The method which is working satisfactorily for our system is as follows: We have zoned the United States, or divided it into as few natural districts as possible, basing our division on the number and amount of transit items handled by our system of banks. At a central point in each of these districts we have established an account with a bank, endeavoring to select a bank which has the largest number of bank accounts and the best transit facilities. We give the transit facilities of our correspondents careful consideration.

MONTHLY ANALYSIS ACCOUNT

These correspondent banks receive but one account from the parent bank of our organization; however, all transactions originating from our system of banks are handled over this account. The account is analyzed monthly by our organization with the view of keeping it at a figure which will compensate our correspondents for the service they are rendering to us, and also allow them to make a reasonable profit. The account is also analyzed by them and a copy of their analysis forwarded to us; this procedure constitutes a

check against our figures. This is done for two reasons: first, we cannot consistently ask them to handle our business at a loss; and, second, we cannot afford to permit too much money to lie idle.

Arrangements are made with the banks at each of these centers to forward to them two remittance letters each day: one letter containing items drawn only on banks located in the same city as the correspondent; the other letter containing items drawn on banks located in various parts of the zone adjacent to the correspondent bank. Through a study of our business we have been able to work out an equalized deferment schedule for each of these zones or districts, so that we know how much time is required to receive collected funds.

MEMBER BANK REMITS TO CORRESPONDENTS

Each member bank is permitted to remit to these various correspondents of the parent bank, marking at the bottom of its letters "For credit of the parent bank." Member banks send two remittance letters in the same manner as the parent bank, and at the time the remittance letters are sent out, they make a special debit against such correspondent bank, forwarding the debit in their regular remittance letter containing debits to the parent bank. These debits are conspicuously marked so that the parent bank can, for the purpose of deferment, readily determine the amount of each kind of remittance. Upon receipt of these debit tickets the parent bank gives immediate credit, but defers for the period of time required for the items to reach their destination, plus what-

ever additional time is required in case of equalized deferment. This equalized deferment, as previously stated, is based upon our experience, and to all intents and purposes is proving satisfactory, as you can readily see that small differences will adjust themselves over a period of time; and even though the time required were greater or less than the equalized schedule, the only difference would be between the parent bank and the member. We have found that from the practical standpoint there is a certain amount of "give and take" to these transactions. We readily admit that you can figure them out to the last penny and make adjustments, but in so doing you will overburden your departments with technicalities and extra labor to the extent that they will become impractical, although theoretically correct. The additional labor and expense of supervision far offset the advantages gained.

CORRECTION OF ERRORS

The city correspondent of the parent bank credits these remittances for the amount as shown by the totals, and if there is an error or returned items the account is charged or credited as the case may be. Only the member bank originating the remittance letter is advised of the credit, errors, or returned items. A statement of account is sent to the parent bank each day, and from this statement the parent bank is able to observe and adjust any outstanding items or differences. To simplify and facilitate the handling of these items, each member bank is given a key number, which number is used as a prefix to all charges or credits,

so that their origin can be identified at a glance. For instance, in the illustration cited above, say that Denver's number was "5": a remittance from Denver would be designated "5 remittance," or Denver's draft number one would be 50001.

In the presentation of items we use both the regular and the air mail service, weighing additional costs against interest earnings on the items. An ordinary letter by regular mail costs 2c, while the same letter will cost from 5c to 10c if sent by air mail. One day's interest on \$1,000 at 2% amounts to $5\frac{1}{2}$ c; therefore it pays to send all items of \$1,000 or over, where the total will amount to a minimum of \$5,000, by air mail, if you can save at least one day in presentation. In case our member banks send items by air mail, they conspicuously mark their debits "sent by air mail," and the parent bank then gives them the benefit of the quicker presentation.

Some of the parent bank's correspondents are granted the privilege of forwarding remittance letters to the various branch or member banks, in which case the branch or member banks remit for the letter by draft drawn on the correspondents. Other correspondent banks maintain an account with the parent bank, and all transactions originating with them are handled by the same methods as are employed in connection with inter-bank transactions.

COLLECTION ITEMS

We will now consider the handling of collections by a branch or group banking system. The procedure is not very different from that of the individual bank, except that

as a rule the branch or group has a greater number of points at which it contacts than does the independent bank, and as a consequence it can handle its collection items without exchange charges in a large number of cases because of such contacts. The procedure most commonly used is to route either direct to the point of payment or through the correspondent bank in the district to which the item is to be sent, asking that the proceeds of collection be remitted to the nearest correspondent for the sending bank's credit by collection number. The correspondent bank does not credit or advise receipt of proceeds until it is actually in possession of collected funds, at which time it credits the parent bank's account and advises the member bank to which the proceeds belong. Upon receipt of the advice the member bank makes up a special debit against the correspondent bank and forwards it to the parent institution for credit. This debit is a special form, and contains not only information as to collection number, but also the date on which the correspondent bank credits the parent bank. The parent bank, upon receipt of this debit, gives interest-bearing credit as of the day the proceeds were placed to its credit, or, in other words, allows the member bank interest on these funds from the day the parent bank receives credit.

DAILY STATEMENT OF ACCOUNT

It may occur to you that funds are thus accumulated without the knowledge of the parent bank. However, the daily statement of account received by the parent bank from its correspondents advises the parent bank, so that in adjusting balances it

can take these items into consideration.

Considerable difficulty was encountered in securing the cooperation of the banks throughout the country in giving our collection number at the time they remitted proceeds, and to offset this we have devised a form which is sent in duplicate to various banks; the first copy is the letter of transmittal of the item, containing instructions, and so forth; while the second copy is their letter, to be used in forwarding proceeds of collection to the correspondent bank.

At the time the collection letter is sent out, a copy is sent to the parent bank. These copies are held by the parent bank merely as an added precaution in case an advice goes astray, or in case it wishes specific information in connection with any particular item. All collection letters are key numbered, or bear a prefix number to designate the originating bank, in order to reduce the amount of labor in describing the item. For instance, if Denver were number "5," this number would be prefixed to all collection numbers; so that in describing the item the parent bank's correspondent need only insert the collection number for the parent bank to know to whom the proceeds belong and from whom to expect the special debit ticket.

SPECIAL ITEMS

In discussing the handling of special items, such as live stock shipments, transfer of funds, special credits, bonds and securities sales and purchases, and other items of a special nature, we resort to the use of the special debit forms referred to in connection with collections. For in-

stance, should John Smith send a trainload of lambs to the Omaha market, all he would have to do would be to instruct his commission firm to deposit the proceeds of shipment to the credit of the member bank with which he is doing business. Through the live stock clearing house this bank's standing instructions are to deposit the funds with our correspondent bank at Omaha; that bank, in turn, has instructions to wire advice of credit to the member bank concerned. Upon receipt of the wire advice, the member bank forwards its debit against Omaha to the parent bank, which adjusts interest on the item, giving the member bank interest from the day the proceeds of the shipment were deposited.

We have a number of grain buying accounts throughout our system whose practice is to supply money from time to time to their agents or representatives at different points where they have buying stations. In handling these transactions we have made arrangements to have these funds deposited in our correspondent bank for credit of the member bank with which the outlying buyer is doing business. Our correspondent then advises the member bank concerned, either by wire or by letter, and that bank then sends its special debit ticket to the parent bank, which adjusts the interest.

PURCHASE OF SECURITIES

The above procedure is followed in handling all similar transactions. In the case of the purchase of securities, and so forth, by the member bank, or in the case of wire transfers by the member bank, the procedure requires a special advice to the parent

bank, which, in turn, makes the charge to the member bank and credits the correspondent, adjusting the interest to be paid the member accordingly. At times it is necessary to transfer funds by wire; this privilege is given all member banks, with certain limitations for mail advice, and with no limitation when advice is given the parent bank by wire. Such limitation in connection with transfers is necessary in order to enable the parent bank to protect its balances.

RETURNED ITEMS

In connection with remittance letters between branches or member banks and the parent bank's correspondents, as well as among themselves, there are always a number of items which, for various reasons, are not paid; and to handle this situation two procedures are followed: A return item between members is considered the same as a check on the bank from which received, and the item is sent back in the remittance letter on the day received. With reference to return items from the parent bank's correspondents, the parent bank's correspondent forwards the item direct to the branch or member bank from which it was received, and charges the account of the parent bank, noting on the account "returned item," giving member or branch bank's number opposite the charge. The parent bank is not advised by the correspondent.

The member or branch bank, upon receipt of the item returned, advises the parent bank on a special form. This form is made up in triplicate. Two copies are sent to the parent bank: one constitutes the parent

bank's credit to its correspondent; the second constitutes its debit against the branch or member bank; the third copy is retained by the branch or member bank and constitutes its credit to the parent bank.

ADJUSTMENTS

By means of the daily statement received by the parent bank from its correspondents, it can check these items closely, and if a returned item is not reported within a reasonable time it must be traced and adjusted. As a rule, no trouble is experienced in handling these items, for the member bank or branch makes the necessary advice and entries for the parent bank at the time that it makes its own credit ticket. Occasionally an item is lost in transit, in which case the parent bank charges the member bank or branch, advising it so that it can secure a duplicate, or pass the charge back to its customer.

It must be borne in mind that the parent bank's correspondent, as well as the member or branch bank, always credits for the total of the remittance letters. Should the remittance letter be short, the parent bank's correspondent debits the difference to the parent bank's account, advising the branch or member bank concerned. Upon receipt of this advice, such bank credits the parent bank's account with the difference and advises the parent bank, which, in turn, adjusts by debiting the member or branch bank and crediting the city correspondent. Should the remittance letter contain more items than the total shows, the parent bank's correspondent credits for the amount of difference and advises the branch or member bank, which, upon receipt of

such advice, makes a special debit for the amount and forwards to the parent bank in its special remittance containing debits accumulated for that day. When errors exist between member banks, if the remittance letter totals more than the items amount to, the receiving bank credits for the total as shown by the letter and makes a debit against the sending bank; such debit being sent to that bank in the receiving bank's letter. But, should the items amount to more than is shown by the total, the difference is credited to the parent bank's account and the member or branch concerned is advised, and forwards a special debit against the receiving bank in its special remittance letter to the parent bank containing special debits.

In explaining these entries, I have mentioned the use of special debit tickets, but I wish to state that not all branch or group banking organizations use the debit system; some use a settlement sheet, which is the same in principle but requires the parent bank to make the necessary forms to meet the particular requirements of its general bookkeeping system. However, in group banking it is necessary to pass as much of this work as possible to each individual bank, to relieve congestion at the parent bank, so that it can expedite its work. As an example, assume that a group had sixty individual units in addition to the parent bank. If it required ten minutes' work at each bank to make these debits or forms for use of the parent bank, it would work no hardship on the individual members, but would require six hundred minutes, or ten hours, of the parent bank's time.

So closely allied with the transit system of a group is the draft privilege, that I am going to explain how

this is handled by some organizations. Each branch or member bank draws drafts over the parent bank's account without limit, on the parent bank's correspondents. The parent bank's name does not appear on these drafts, but the correspondent bank has authority and general instructions to charge these drafts to the parent bank's account. These drafts are reported each day by the branch or member bank to the parent bank on a special form provided. A separate report is required for drafts drawn on each correspondent. The member bank uses a regular draft register, wherein is recorded the payee's name, the date, the amount, by whom purchased, and so forth. The branch or member bank sends the parent bank the first three copies of the draft report form. This form is dated and shows all drafts drawn by the branch or member bank on the parent bank's correspondent for that particular day by number and amount. The parent bank, upon receipt of these three copies, uses them as follows: The first copy constitutes its draft register; the second copy, its credit to its correspondent bank's account; and the third copy, a debit to the branch or member bank. The member bank uses the fourth copy of this report as its credit to the parent bank. The parent bank receives the advantage of the float on these drafts, but this is offset by other advantages the branch or member bank receives through having only one account, which permits a more economical operation. In case a draft drawn by a branch or member bank is paid by such bank, it forwards the draft in its remittance letter to the parent bank, which makes the adjustment. If a draft is mutilated or spoiled, it is so reported on

the report of drafts drawn, so that the parent bank has a numerical check on all drafts being issued by the branch or member bank, which shows whether the branch or member bank has failed to send in a report covering drafts which may have been issued. Twice each month (or more often, depending upon the procedure adopted by each organization) these drafts are returned to the branch or member bank for its files, so that the draft becomes a record after payment in the files of the issuing bank.

SUPPLIES

In connection with supplies, the employment of a uniform system permits the use of like forms by various branches and member banks, thus allowing quantity purchases and creating a saving which, taken over the entire system, means considerable reduction in expense. In addition, it insures a uniform method of handling items throughout the organization, which again means a saving, as employees are easily interchanged without the necessity of teaching them new methods or acquainting them with new forms and systems.

You can readily see the many problems which have confronted the group or branch banking organizations in the evolution of their transit and collection departments. I believe, however, that the systems outlined operate for efficiency, economy, and greater profits, as they are easily understood, easily operated, and designed to prevent duplication of labor.

Discussion

THE CHAIRMAN: You have listened to a very comprehensive paper

on the organization of a transit and collection department in a branch or group banking system, a paper that is really a composite of the systems in use at the present time. As was indicated a moment ago, you may be next; incidentally, did you notice that ten-hour day that they referred to in a group banking system? You may be next, so, regardless of your present position, I take it you are all keenly interested in this question of developing these arrangements in a group or branch banking system.

CHARLES HEMMINGSEN (First Seattle Dexter Horton National Bank, Seattle): I should like to say that I can see where it can be a saving of at least a day's time in many transactions, and I should appreciate it if I could get a sample of some of those forms you are using. It is an idea we have thought about, but we have just been reorganized and we have not yet come to that point.

MR. CANFIELD: If any one here wishes these forms, if he will write direct to us at Ogden, I shall be more than glad to supply him with a copy of the forms we are using.

At this time I wish to give credit where credit is due; the majority of the systems we are using in our own organization we have adapted to our peculiar requirements but have taken from the Bank of Italy National Trust and Savings Association.

DON CROULEY (Northwestern National Bank, Minneapolis): Is it compulsory for your branches or members to exchange items among themselves, and if so, does it not entail a considerable amount of work and postage, as far as sorting and listing of items is concerned, to your correspondents throughout the country?

MR. CANFIELD: In answering that I will say that it is not compulsory, but where a remittance letter contains a large number of items, or in the aggregate, amounts to more than \$500, then we ask that it be sent direct; otherwise these items go direct to the parent bank.

THE CHAIRMAN: If you had 300 banks as we have, and all transactions were centralized in one place, you would have a transit department there which would be the largest in the world.

The thing that the speaker referred to in regard to distributing expenses, and so forth, is another item.

MR. CROULEY: The reason I asked is that we have 110 banks, and it would entail a lot of work.

THE CHAIRMAN: But the work would be distributed among those 110 banks rather than centralized in one place and would bear less expense accordingly.

HENRY LACHENAUER (Fidelity Union Trust Company, Newark, New Jersey): Where you have a bank with branches within that city, you have the main office handle the majority of the work, don't you?

THE CHAIRMAN: With us, and I take it it is usual with branch banking systems within a city, we have in every city a central clearing branch; that is the only one in the city that operates a clearing or mailing department; all incoming mail is delivered to that central branch. Items payable at the branches within the city are there distributed to those branches through what we call an interbranch blotter system, an arrangement by which transactions are interchanged within branches in the city, just as they are in departments in a unit bank.

OWEN E. THOMAS (Federal Reserve Bank, Minneapolis): In the case of collection of trade acceptances not falling due two weeks from the date they are deposited with the branch bank, does the branch bank forward right on to the place of payment? If they are payable in the city and not in outlying districts, is credit given by the parent bank only upon receipt of the payment by the collecting bank?

MR. CANFIELD: In answering that I will say that trade acceptances or any other form of investments are carried in the individual bank investment account until they mature. Prior to that maturity, of course, they are sent for collection and handled like any ordinary collection. I think I explained that in my paper. The parent bank gives credit to the member or branch the day the funds are collected, although the actual credit may not go on the individual bank account or books until several days after the credit has actually passed, although they receive interest from the day the funds are deposited.

THE CHAIRMAN: And also, following from that, an item deposited for collection would be held by the receiving bank and forwarded only after reasonable time for maturity.

MARION S. BURDETT (Walker Brothers Bankers, Salt Lake City): We are one of the largest banks in our vicinity and we have a good many correspondent banks, while we are a unit bank within ourselves. However, to meet competition we have installed the same group system that Mr. Canfield mentioned. We have our correspondent banks send their cash letter for credit at our own bank. Do you find any objection to that, Mr. Canfield?

MR. CANFIELD: I would, yes; for the reason that you do not control the individual units and you have no means of controlling them so as to force them to make proper adjustments. I think that would be my own objection to that.

HARRY R. SMITH (Bank of Italy National Trust & Savings Association, San Francisco): In that arrangement you speak of, do you require that the correspondent bank enter into any agreement as to its participation in the plan regarding handling returned items, and so forth?

MR. BURDETT: Naturally we do. In fact, we supply all the forms and everything for the correspondent banks; they are handled in the same way that a group bank is. We made that arrangement before we proceeded.

MR. BURDETT: Mr. Canfield, do you use the Federal Reserve System for your collections at all?

MR. CANFIELD: Where we can use it to advantage we do, but here is our peculiar situation. We have only key banks that are members of the Federal Reserve System. The majority of our banks are not members and they of course could not send items to the Federal Reserve bank. We have a bank in Salt Lake City and we also have our city cor-

respondents located throughout the United States at such points that we can send direct to these city correspondents and get direct presentation without the necessity of going to the Federal Reserve Bank of Salt Lake City. However, I may say that a good many of our items are ultimately handled through the Federal Reserve bank. We have an arrangement with Mr. Anderson's bank whereby it handles for us all items east of Illinois. That is worked out on the plan which has been outlined by the Cleveland Trust Company, which, as far as we are concerned, is a three-day return on all items east of Illinois, from any one of our member banks. If those items were sent through the double Federal Reserve bank, it might require as long as nine days before we would receive returns.

MR. BURDETT: Mr. Anderson made the statement that he thinks that eventually the Federal Reserve bank will handle the collection of all transit items. Would it not be well to defer that statement until we know the outcome of the chain banking system? As I understand it, there are several chain banks on the coast that handle all items without the Federal Reserve bank—in fact they are not members of the Federal Reserve System.

The Personal Touch in Handling Collections

By E. L. UHLIK

ASSISTANT CASHIER OF THE SECURITY-FIRST NATIONAL BANK OF
LOS ANGELES, LOS ANGELES, CALIFORNIA

Address before the Denver Departmental Conference

There is a growing tendency to stress collection service, since quicker and more efficient collections create larger balances. Mr. Uhlik himself summarizes his main suggestions for expediting this service in the following paragraph:

"If the sending bank starts the collection promptly and with proper instructions as to its handling, and if the receiving bank follows through, intelligently, in accordance with these instructions, a perfect cycle of operations is the result. Let one point of contact be missing in this cycle, however, and we receive criticisms, tracers, and possibly telegrams that all total up in needless expense, sometimes to the customer, but more often to all the banks in the cycle."

THE handling of collections is one of the most important functions of a bank, because it is a business builder and a source of revenue; and for these reasons specialized training is necessary to familiarize the members of collection departments with the innumerable and ever changing situations growing out of new trends of banking practices, conditions of finance, credit ratings, rapid transmission through use of air mail, and so forth.

The advertisements in the Rand McNally Bankers' Directory indicate the growing tendency of banks to stress their collection service. Why is this subject of collections coming up for so much attention now, since banks have been conducting collection departments for years with little or no attention from the senior management? The answer is: Quicker and more efficient collection service cre-

ates greater balances; and quick and efficient service can be achieved only through the personal touch in handling collections.

There are several distinct types of collections, and in the larger banks, where volume justifies it, these various classifications are handled by departments specializing in each type. For instance, note or instalment collections consist of items left with banks on a contract basis for the purpose of collecting the payments as they become due. This class of collection is usually handled by larger banks in a separate department generally known as note collections. The treatment of this type of collection will not be discussed at this session. It is mentioned merely to classify definite types of collection items.

Our main subject, then, will be confined more narrowly to incoming and outgoing collections. They are

so closely related that a segregation into two distinct operating departments need be made only when volume warrants.

HANDLING OF COLLECTIONS

The manner of starting a collection on its course either facilitates or hampers its collection by the receiving bank. This initial handling is analogous to a little sneeze and potential pneumonia, the outcome depending on the treatment. Proper treatment by a good doctor may prevent the development of pneumonia; likewise, intelligent initial handling by a good collection man does often prevent loss in time and money to the customer and to the bank. Too much stress cannot, therefore, be placed on the importance of the personal touch in the initial handling of the collection.

Protection to the customer and to the bank starts with the completeness of the item itself, such as date, maturity, indorsements, attached documents, and so forth, and the collection teller accepting the item is responsible for determining that everything is in order.

At this time the teller should ask the customer for forwarding instructions, whether to forward the item marked "protest" or "no protest," and, especially, as to the disposal of the proceeds. We have found it to be a very good plan to secure the customer's signature on the collection receipt form, not only to verify the identity and ownership of proceeds, but to authenticate the instructions given. Also at this time we can inject a little of the personal touch, because in many cases the customer will mention something about the item which will indicate the need for

special instructions. Often a timely suggestion can be made: that the use of air mail may help to speed returns, or that a wire advice of fate or wire advice of credit will save several days' time at a small cost. Such suggestions on the part of the collection teller indicate to the customer that the bank has his interests at heart.

The choice of good bank collection agents at certain points throughout the country should be given the most careful consideration. Experience with certain banks, of course, is the best indicator as to where proper service may be expected. However, this takes time to learn. A good way to obtain information on certain districts is to request good banks at pivot points to give you an indication of the territory which they can cover to your advantage.

Another important item is the use of a collection form distinctive in appearance, contrasting with the cash letter form, and providing spaces for your collection number and special instructions.

A collection may be either "cash" or "non-cash," the distinction being that cash collections are those items for which the customer has received credit (subject to final payment) in his account; while non-cash collections are those which the bank has accepted from the customer against a receipt for credit or payment of the proceeds when actually collected.

Deposited items, such as documentary drafts against individuals or corporations, establish a distinct credit phase, separate and apart from ordinary check deposits, in that the sending bank assumes a greater risk or responsibility. This is particularly true if the draft covers perishable commodities.

Inasmuch as the receiving bank is not always in a position to know whether an item is a cash or a non-cash collection, the service rendered must be of the utmost accuracy and expediency, as a protection to the sending bank.

The importance of definite, explicit, and complete instructions on outgoing collection letters cannot be stressed too strongly. Also, the strict adherence to these instructions by the receiving bank will eliminate a great many of the difficulties and misunderstandings that result from negligence in this respect.

CASH COLLECTIONS

Because they require individual handling in contrast to the volume handling of ordinary checks, items of this character should never be forwarded on ordinary transit cash letters, for the very simple reason that cash letter instructions are not sufficient to govern the receiving bank. They call for specific collection instructions, and should invariably be sent by the sending bank on numbered collection forms, with full and complete instructions.

A point I should like to mention at this time is the importance of securing adequate official approval covering the acceptance of items for deposit, which are not strictly in the ordinary check class. It has been our experience that customers will take for granted that they may deposit practically any kind of piece of paper to their account, just mixing these special items with the ordinary check and cash deposits. Possibly you will find that you have something very dangerous on your hands unless this precaution is taken.

A cash collection may be any kind of negotiable instrument that requires hand presentation, such as drafts with bills of lading attached, drafts with securities attached, drafts with any documents attached, drafts against individuals or corporations, checks upon which the bank or customer wishes separate advice, checks with pass books attached, trade acceptances, or notes.

NON-CASH COLLECTIONS

Non-cash collections also may be any of the kinds of negotiable instruments mentioned above, but they are accepted on a receipt rather than on a deposit, and are handled as collections for such reasons as that they may be left by a prospective new customer, a total stranger, a customer to whom you do not wish to advance credit, or one who does not wish credit until the item is paid, in order to reduce float or interest charges, or so that special advice of fate may be received. Or perhaps your customer is dealing with a stranger in the manner of a stranger dealing with the bank; thus, the bank's collection service is his protection.

The ordinary depositor does not understand banking practices, and a bank automatically becomes his agent in the transaction of his collection business. It is the bank's duty, therefore, to look after its customers' interests as it would its own, in starting an item correctly in order to create a valuable and favorable impression.

Unfortunately, this favorable impression may be destroyed if the handling banks fail to give the service called for by the sending bank's explicit instructions. Let me again stress the importance of explicit instructions

by the sending bank, and the strict adherence to these instructions by the receiving bank, for without this hand-in-hand coordination, you cannot expect good collection service.

INDORSEMENT ON THE INSTRUMENT

One of the common omissions of the personal touch in handling collections is the indorsement on the instrument.

This means that the customer's indorsement should be on any check or draft which requires an indorsement. Bills of lading must be indorsed. In addition to any required individual indorsements, the sending bank must place its own indorsement stamp on the back of the draft or check, but not on the bill of lading or other attached documents.

There are two types of bank indorsement stamps, each having a distinct purpose in collection work. The one most commonly and properly used incorporates the wording "prior indorsements guaranteed," or a similar phrase. It should be used on all items which are indorsed by individuals and other banks known to you.

The other kind of stamp reads "for collection," and does not incorporate the wording "prior indorsements guaranteed." Unfortunately, this stamp is used in error to a very large extent, resulting in extra expense in telegrams. The most common uses of this "for collection" stamp, and they are very few, include the indorsing of items of which your bank is the payee, such as a transfer of an account to you; acceptances; notes; and, in extremely rare cases, an item that has been indorsed by a total stranger who cannot furnish identifi-

cation for you to accept even for collection. In other words, this stamp should be used on items that you want paid on signature or indorsement only. Apparently, many collection tellers do not understand the danger in accepting items indorsed by banks whose stamp does not guarantee prior indorsements when necessary.

SUPPORTING DOCUMENTS

There are certain types of drafts and checks which require supporting documents before they will be paid. These are invoices, which enable consignee to know quantity, quality, and terms regarding the shipment; pass books, which must be attached when necessary; insurance policies, which are required by some companies on their settlement checks; drafts, which, if drawn on telegraphic guarantees, should state that fact very plainly on the face of the draft; and government inspection certificates, which should be attached when the shipment of produce is made to points where the certificate is necessary.

ERRORS IN COLLECTION

Some collection tellers do not take into consideration, when wiring for the fate of an item, that there is a difference in time between points in the United States of as much as three hours, and four hours when one end uses Daylight Saving time and the other does not. I mention this because of the useless telegrams that are sent at the close of the day's business when there is a very good chance of the collecting bank's having already sent a wire which would be received in the morning, advising fate. A study of this difference in time should be

made, as there are many dollars spent on telegrams that do not obtain desired results.

It is the practice of many individuals, companies, and banks to staple documents to either the draft or the collection form. The practice should by all means be discouraged, as it makes inspection of the documents a difficult job unless they are torn open.

Another serious form of error is the remission of collection proceeds by methods not in accordance with the instructions of the sending bank, some banks even making the unpardonable mistake of remitting a cashier's check, which, in reality, merely creates another collection, since it cannot be used by the bank accepting the proceeds as a payment. Also, when a collecting bank remits the proceeds to another bank as instructed by the sender, all tangible information should be given to the correspondent bank so that it may be in a position to forward proper advice; and especially in the case of a branch of some parent bank's forwarding an item for collection, the branch name, location, and number of the collection should be very carefully mentioned in the letter of transmittal of proceeds.

Any deviations from the procedure just mentioned encourage endless tracing, which makes extra work for both the sending and the collecting banks.

Speaking of tracers, it is our daily experience to receive a large number of forms, supposed to be tracers, but, in reality and effect, nothing more than unnecessary follow-ups. We receive these forms of tracers before the sending bank could possibly, under any condition, receive our advice of fate or acknowledgment. Collections

should not be traced until sufficient time has elapsed for the receiving bank to effect collection and make returns. Further, they tend to depreciate the true value of tracers.

"Wire fate"; "wire non-payment"; "hold for arrival"; "at sight," or a certain number of days' sight; "protest" or "no-protest"; "remittance of proceeds": these are all very commonly used phrases in collection work, but if not shown clearly on the letter of transmittal (or, in other words, the outgoing collection form) they lose their value. We have found that a small instruction form, firmly attached to the collections, indicating very clearly the manner in which the particular collection is to be handled, assists the receiving bank considerably; because the instructions incorporated in this little tag may be copied by the receiving bank on its incoming record and its collector then has our original instructions to work from when making presentations to the drawee.

The fact that the receiving bank must be guided by the sending bank's instructions, and not those of the individual indorser, makes it necessary for the sending bank to copy its indorser's instructions on the outgoing collection letter. This point should be thoroughly understood, because a collecting bank is an agent of the sending bank and not an agent for collection of your customer.

THE PERSONAL TOUCH

If the sending bank starts the collection promptly and with proper instructions as to its handling, and if the receiving bank follows through, intelligently, in accordance with these instructions, a perfect cycle of opera-

tions is the result. Let one point of contact be missing in this cycle, however, and we receive criticism, tracers, and possibly telegrams that all total up in needless expense, sometimes to the customer, but more often to all banks in the cycle.

All the points that I have been mentioning have a bearing on the personal touch in handling collections, but they are for the most part merely logical methods of operation, so the real personal touch, to me, enters at the point where logical operations stop, best explained by some concrete examples.

For instance, we have had sent to us a bill of lading collection, which the sending bank has instructed us to collect on arrival. It is our duty to keep in touch with the freight yard or steamship arrivals, to ascertain whether that certain car or steamer mentioned in the bill of lading has arrived. The drawee should be notified at once (even though shipment has not arrived), so that he may know which bank holds the draft and the nature of the shipment, and if there is a difference of any kind it may be corrected before arrival, which saves demurrage charges. We should never rely on the drawee to follow up on arrivals, because certain types of shipments deteriorate very quickly, and the outstanding fact is that the drawee may not wish to take up the draft, because of controversy or financial difficulties.

Both the sending and the receiving bank should notify the indorsers whenever returns are not promptly received. This allows indorsers to give instructions by which you may be guided.

In connection with notices and presentation of collection business, we

should not overlook the value of one of the smallest cogs in our wheel, the collector or messenger. Select him carefully, for he is your bank's house-to-house salesman. His approach and conduct when dealing with collection customers creates either a favorable or an unfavorable impression about your bank.

Another form of protection to your customer is in the case of bill of lading drafts that have been discounted by your bank; or, in other words, deposited to the credit of your customer. Many banks use a small rubber stamp impression on the face of the draft and on the collection letter, reading in substance: "This draft has been discounted by (name of your bank) and the proceeds are the sole property of this bank." This will often eliminate attachment of the proceeds in the event of any dispute between the shipper and the consignee.

The personal touch is most important whenever items are sent by air mail, with instructions to "wire fate" or "wire non-payment." Some person, or the sending bank, is unusually interested in this transaction, or the collection would have been allowed to take a slower method of transmission and its fate not investigated except in due course. Therefore, attention beyond the usual good handling should be given these items.

A certain person once left a draft with a bank for collection, and the person leaving the item against receipt was nervous and fidgety at the time. The collection teller noted it, mentally, but incorporated the impression in the collection letter and suggested that the maker be contacted by the drawee bank before paying because the indorser was unknown. The collection bank conveyed this

information to the drawee bank, which, in turn, contacted the drawer, receiving the answer that the item was a very clever forgery. The drawee bank would undoubtedly have paid the forged item because of the cleverness of the forger; however, a wire was immediately dispatched and the person apprehended. This was putting the personal touch to an item by observation, and it is observation and proper handling, along the entire line of collection that may result in that outstanding performance which gains new friends and retains old customers.

Discussion

STEPHEN J. SPELLMAN (Lincoln Alliance Bank & Trust Company, Rochester, New York): When a bank guarantees payment of a draft, does that ordinarily become an intangible liability to the bank entertaining the guarantee?

MR. UHLIK: I don't know that I can answer to your entire satisfaction. We had a recent case in Miami, Florida, in the last bank failure down there, where there were something like nine guaranteed bill of lading drafts in the possession of that bank. I will admit frankly that I will endeavor to refrain from answering a legal question pertaining to collection matters. Collection matters are so broad in their legal phases that it is almost impossible to answer them because I do not think any two attorneys will agree on any type of settlement. It rests quite a bit with the receiver of a defunct bank. You did not mention the defunct bank but it possibly results in the same thing. Otherwise you would have no worry.

MR. SPELLMAN: I believe the name Christie & Son is familiar to

you on the Coast. We have had drafts that we have been instructed to guarantee payment on and the Lincoln Alliance Bank & Trust Company of Rochester holds those as intangible liabilities. I wanted to ask why those drafts are sent to other local banks when we guarantee payment?

MR. UHLIK: You are possibly not the correspondent bank that accepted the item. Banks deal with correspondent banks whenever they can. In our case we choose certain banks in certain cities, pivot points, of course. Of course we have our correspondent relationships, but where we do not have a correspondent relationship, we choose a safe bank in that city and send it to that bank regardless of whether there is a guarantee on it or not.

I mentioned in the paper the fact that if the draft is drawn on a telegraphic guarantee, it should be shown very clearly on the face of the draft, even though you do not receive the draft which you guarantee direct from the sending bank; you will receive it in due course. Regardless of how you pay it, you have to pay it, so it really does not make much difference whether you receive it direct or through another bank in your own city.

MR. SPELLMAN: Where we have had difficulty is that after the drafts have been guaranteed, we have had to send telegrams to find out where the draft has been sent and why we have not received it. Finally we find it has been paid through another local bank.

MR. UHLIK: No, you would be the only one that would pay a guaranteed draft.

MR. SPELLMAN: We would be?

MR. UHLIK: So far as you know, your customer would not pay it if the guarantee by you had already been accepted. In other words, they have not paid you for the draft. You merely accept their credit line.

MR. SPELLMAN: Yes.

MR. UHLIK: Then the other bank across the street presents it direct to the drawee and he pays it direct to the other bank across the street. Your customer is wrong, then, because he sets up a guarantee with you covering a specific shipment. He most certainly should refer that draft over to your bank for payment.

MR. SPELLMAN: What I cannot understand is, why after we guarantee the draft, would they send it to another bank even though it is a correspondent bank?

MR. UHLIK: That rests entirely with the correspondent bank.

FRED J. ROBERTSON (Peoples Wayne County Bank, Detroit): I was very much interested in what Mr. Uhlik said about following up the arrival of shipments of perishable goods and goods which will deteriorate. I am wondering just what your procedure is on that. You spoke of handling about 3,500 items. On any one of our busy days at the main office we handle perhaps two-thirds that many, but we have never made a practice of checking up with the companies on arrival. In other words, the customer was notified; it was left to him to find the bank where his draft was, if he was not notified, although we make an attempt to notify everybody who has a draft sent to us. Just how do you handle that and how much time does it take?

MR. UHLIK: By 3,500 drafts

I do not mean 3,500 bill of lading drafts. Those are various types of collections. We handle possibly 600 or 700 actual bill of lading drafts.

MR. ROBERTSON: What I meant was that in a large volume like that there necessarily would be many of these drafts to be followed up. How do you handle the matter?

MR. UHLIK: We inform the railroad company that the bill of lading designates that shipment is coming over. It shows the car number, and your yardmaster can tell you in five seconds whether that car has arrived or not. One of our collection men is on the telephone possibly five minutes on all the drafts that we have. He telephones every day on these certain cars. The yardmaster says yes or no; if it is yes, we notify the payer again, immediately. But it does not take over five or ten minutes at the most for the check with the freight yard.

MR. ROBERTSON: What do you do—get in contact with them immediately upon arrival?

MR. UHLIK: Yes. That makes a second notification to the drawee. We tell them right then: "The car has arrived. Will you come in and pick up your draft or shall we send it out to you?"

MR. ROBERTSON: I think that is a very good suggestion. I cannot recall any cases where anything like that has come up lately where any one has been charged with the loss through something like that, but it is a good point when you are handling a large volume.

MR. UHLIK: A great deal of this discussion may possibly prevent loss. That is what I endeavored to emphasize—that loss can result from collection work.

MR. ROBERTSON: On your bill of lading drafts especially, do you have many companies that bring in large numbers of them daily?

MR. UHLIK: Yes.

MR. ROBERTSON: We do. We have the motor car companies. Do you handle many of those payments by wire?

MR. UHLIK: I know you are subject to that. I know your Mr. Wilson. The subject is very broad in that you want telegraphic transfer of funds to a certain point covering all motor car shipments; this is a demand on you by the motor car company. In other words, that is an establishment of correspondent bank relations. It is a subject that goes a little beyond collection work.

GLADYS F. MANCHESTER (Third National Bank, Springfield, Massachusetts): Do you use the Federal Reserve System on your collection work?

MR. UHLIK: That gets more into correspondent relationships again. We have correspondent banks in practically every center where a Federal Reserve bank is located; therefore, we would rather use our correspondent bank than the Federal Reserve bank, and that is no discredit whatsoever to the Federal Reserve System. When they handle a collection it is done very efficiently. That is our experience. But we choose the correspondent bank for the handling of our business not strictly in preference to the Federal Reserve bank, but because we can take credit at the receiving end.

VERNE P. MAPLE (Security First National Bank, Fresno, California): Referring to Mr. Robertson's criticism of our sending these drafts to some other bank in that

locality instead of to the bank that creates the guarantee, it occurs to me that perhaps the very lack of this personal touch which we are speaking of might be one of the reasons for the bank's sending it through another bank. It feels that possibly that bank will not have the interest and best wishes of the drawee at heart. In other words, it will act more in accordance with the wishes of the correspondent bank than with those of the person that is making the guarantee. We have had that experience in a number of instances.

THE CHAIRMAN: In connection with these guaranteed drafts, particularly the grape shipments of which we have so many in the West—Mr. Maple of course comes from the grape-growing district of California—it has been our experience that oftentimes a grape grower will not ship his grapes until he has the money in his hands, and we have found that buyers of grapes sometimes want to hedge on taking the shipment after they get it because sometimes they do not allow for a certain percentage of spoilage and for delays in transportation and other things, and they do not find quite as much juice when they get the grapes as they thought they were going to have. So as a rule it is our practice, even though a bank has guaranteed the draft in a city, to send that draft to the correspondent bank on the presentation.

MR. MAPLE: Why is it necessary to repeat the customer's instructions that are incorporated on the draft itself on the sending bank's outgoing collection records?

MR. UHLIK: Because the receiving bank is an agent of the sending bank and unless the sending bank incorporates its customer's instruc-

tions on the letter of transmittal, there are no instructions with the collection whatsoever; so it is possible that without your consent the instructions are printed on that certain draft; you may not want that certain draft sent in accordance with your customer's instructions. You may have some money in that draft yourself.

ROBERT L. SNOOK (Texarkana National Bank, Erhart, Texas): Nearly all of the bill of lading drafts that come to us come with a different order and bill of lading. We receive personal data and nearly all of forty-eight hours' guarantee with the railroad company. They can hold almost anything they want to. Sometimes they are accepted and sometimes they are refused. The bank is not consulted. We could not forcibly pay the draft even though they have accepted or refused the merchandise.

MR. UHLIK: That is commonly termed a railroad guarantee. The railroad is responsible for that shipment then. But from your angle, you should most certainly put the sending bank on notice immediately on either a negative or an affirmative answer to your presentation.

OWEN E. THOMAS (Federal Reserve Bank, Minneapolis): Before we get away from the bill of lading draft proposition, I should like to state some of our grievances in Minneapolis. It has been our experience covering thousands of drafts from the Pacific Coast and the South that there has been a great deal of gnashing of teeth over some of these drafts. You would be surprised at

how many bill of lading drafts we get where the draft is drawn on demand and subject to protest. We make demand and the draft is sent out at the same time as the shipment. It will probably take a week to get it there. It causes a great deal of antagonism between the customers.

Still another class of bill of lading drafts which are not so satisfactory are the drafts attached to bills of lading covering food shipments payable on arrival, and others payable on arrival after inspection and no protest. We have had experience with some of those buyers where in some way or other the delivery has been made by the railroad company, and they have insisted that we hold for arrival; it sometimes takes a period of several weeks to trace and then we are notified that the car has been delivered although payment has not been made. It seems to me that a more satisfactory way would be to have the shipper consent to send those drafts subject to protest on arrival and after inspection. Then it rests with the buyer. He will have to admit that the goods are there. These men do not want those drafts to be protested. They will pay rather than have them protested. That is the point I should like to make here. I have had the opportunity of handling so many thousands of drafts from the states of Washington and California and from the South that come in just that way. If "no protest" were left off, payment could be hastened. They would admit that the goods were already in and would pay the item.

A Teller's Responsibilities

By CHARLES E. SHEPARD

CASHIER OF THE CITIZENS AND SOUTHERN NATIONAL BANK,
ATLANTA, GEORGIA

Address before the Denver Departmental Conference

The obligations of the teller fall within the deposit function division of the bank. Mr. Shepard discusses the following specific responsibilities of the teller:

1. The problems and risks involved in the handling of telegraphic transfers and payments
2. The encashment of drafts drawn under letters of credit
3. The encashment and sale of travelers' checks
4. The opening of new accounts and the precautions against fraud for the protection of both tellers and officers
5. Other matters in connection with the duties and responsibilities of paying, receiving, new accounts, and exchange tellers.

It is most important that the teller should be alert, courteous, and friendly. The teller's attitude has a definite effect upon the customer, and is useful in building up and in maintaining a feeling of friendliness between the customer and the bank.

THE business of banking is divided into two main functions, namely, deposit and credit. Associated with each of these functions is the use of money and the various instruments of credit. During recent years, however, several other functions have been added, such as trust service, investment service, and so forth. The responsibilities of a teller fall in the deposit function division.

The time allotted for this presentation will permit consideration of only a few of the outstanding responsibilities of a teller. We trust that they will be not only interesting, but also useful, to a teller in determining his responsibilities. They are divided into two classes, those relating to the customer, and those relating to the employer.

The responsibilities in connection with the following will be included in this discussion:

1. The problems and risks involved in the handling of telegraphic transfers and payments
2. The encashment of drafts drawn under letters of credit
3. The encashment and sale of travelers' checks
4. The opening of new accounts and the precautions against fraud, for the protection of both tellers and officers
5. Other matters in connection with the duties and responsibilities of paying, receiving, new accounts, or exchange tellers.

In most of the larger banks, the teller receives the deposits of customers and pays checks, and the re-

sponsibility of the other functions enumerated above is placed upon an official. In recent years the designation "teller" has, like almost everything else, changed quite materially; years ago the title to some extent represented an official position.

TELEGRAPHIC TRANSFER AND PAYMENT

It is not advisable to honor open telegrams ordering payments or transfers of funds, as it is always difficult to determine the authenticity of messages not coded. A coded telegram having no test word should also be questioned, particularly one authorizing a payment to an individual or a concern of questionable standing. In other words, in order that the interest of all concerned may be properly safeguarded, such telegrams should be in code, with the proper test word attached. When messages are sent in a code in common use, it is advisable that each bank have a different fixed number for use in the computation of test words.

When a stranger comes in and requests you to wire his bank or some firm or individual to transfer money to him, suggest that the way to handle it would be through the telegraph office. Explain to him that this is the quickest way (do not forget that he is in a hurry; if he were not he would not request that it be handled by wire). In the end it will be decidedly to his advantage, as the telegram may be received by his bank after hours, and, in this event, it would have to await attention until the following day.

If you can induce him to handle it through the telegraph company, it will relieve you of any danger of loss

in the transaction, such as payment of money to an unauthorized person, the possibility of bogus wires, loss through remittance being made by the remitting bank in distant exchange or cashier's check, or the closing of the remitting bank before funds can be realized on.

In disbursing funds on wire request, it is suggested that receipts in triplicate be taken, on approved forms, two to be returned to the bank authorizing payment, and one to be retained for your files.

CASHING OF DRAFTS UNDER LETTERS OF CREDIT

Let us consider now the cashing of drafts drawn under letters of credit. It is customary for a bank that issues its own letters of credit to ask banks in certain cities to act as paying agents for its letters of credit; at the same time authority is requested to insert the name of the paying bank on the issuing bank's list of correspondents, which is a printed list handed to the customer and contains the names of banks which have agreed to act as correspondents.

If the authority is granted, then the issuing bank forwards a specimen of its letter of credit and also a list of signatures of the officers who are authorized to sign for the issuing bank.

These documents are then filed, and, when the holder of a letter of credit presents it, the teller should refer to his file and should follow this procedure:

1. Compare the signature of the officer who signed the letter of credit with his signature on the officers' list to make sure that it is genuine.
2. Ascertain that the letter of

credit has not expired, by noting the issuing date and also the expiration date.

3. Ascertain how much remains in the letter of credit after referring to the record provided for the insertion of amounts cashed by other correspondent banks.

4. Draw a draft for the amount which the holder of the letter of credit requests, and then be certain to have the holder sign the draft in the presence of the teller.

5. Compare the signature on the draft very carefully with that contained either on the letter of credit or on the card of identification.

Some banks, in making payments against letters of credit, take duplicate drafts for their files.

TRAVELERS' CHECKS

The seller of travelers' checks receives them under trust receipt, agreeing to remit the proceeds of any sale to the issuer, and to account for those unsold. In the event of theft or forgery, the issuer is morally obligated to honor checks in the hands of innocent holders in order to maintain a high degree of negotiability of the instruments. It naturally follows, therefore, that every precaution should be used, not only by the bank issuing the checks, but by its agent as well.

NEW ACCOUNTS

It is always desirable that those who are engaged in the opening of new accounts should be alert to receive into the bank new depositors and new business of the right kind, but it is equally essential to avoid letting undesirable depositors, or prospective customers with possible malicious intentions, get into the bank at all.

In presenting out of town or clearing house items for deposit there is a great opportunity, unless the customer or depositor is known or can be definitely identified as responsible, of defrauding the bank, and there appears to be during these times an unusual number of people operating with this intent.

When an out of town item is presented as a whole or part of a new deposit, it should be considered in a similar light, as to its worth, as a teller would consider such a check presented to him for cashing. Therefore, unless identification is sufficiently positive, such a check should be accepted for collection only, and the prospective depositor should not be given credit until the check is actually collected.

When such items are taken for collection, you should secure identification and signatures as usual, holding them in your files until the proceeds of this check have been collected and turned over to you by the collection department.

An exception may be made to the above method: you may open an account with out of town items and issue a pass book where you are thoroughly satisfied as to the identification, responsibility, and character of the individual.

As in the above case, should you accept checks on out of town points which you do not put through the collection department, the deposit ticket may be marked to show the point on which the item is drawn for collection, and marked "Do not pay for _____ days," and it should be oked by the teller opening the account; also the same marking and okeh should appear on the signature card.

In accepting an out of town check from a person who is unknown to you, have the check indorsed by the payee, and then follow it up with the following restricted indorsement: "Pay only when satisfied of the correctness of this signature and authenticity of the transaction." We use the following stamp on items handled under similar circumstances:

"We take this item for collection from a total stranger to us at his request. Pay on identification of signature or indorsement, without recourse on us. No protest.

The Citizens & Southern National Bank
Central Office
Atlanta, Georgia."

SAVINGS ACCOUNT NOT SUFFICIENT IDENTIFICATION

It should be of value to realize the real danger which lies in the practice of accepting the fact that an individual has a savings account in the bank as satisfactory identification, for it is not practical to surround the acceptance of savings accounts with the same degree of protection that should be used in accepting checking accounts. Indeed, it is possible for almost any one to open a small savings account in any bank, particularly if the initial deposit is cash. The mere fact, however, that such an account has been opened should not be accepted as vouching for the customer in connection with the more important transactions where absolute identification is essential.

In the event of no introduction, many banks have the signature of the person opening the account confirmed, using an appropriate form for this purpose, regardless of whether the initial deposit is represented by check or currency. This precludes the possi-

bility of your blank checks getting into the hands of a person who will make improper use of them.

Information should be obtained from the former banking connection of your new depositor as to its experience in handling the account, and further information as to his character and financial responsibility will be valuable for your credit files.

Signatures against corporate accounts must have the official title of the officer or officers signing and must be supported by a copy of the resolution passed in directors' meeting which authorizes the official signatures, and this, in turn, must be certified to by the secretary of the corporation and the corporate seal affixed.

On trustee, administrator, or guardian accounts you should require either the original of the letters testamentary or a certified copy of these, at the time the account is opened.

It seems to be more and more general practice to pay and receive at one window instead of at separate windows. This has many advantages. One is that the teller can see what kinds of items are deposited and, thereby, to a great extent, govern himself in paying out.

Detecting counterfeit currency requires close attention to appearance and feel of both genuine and counterfeit bills and coins. Cash must be kept in proper shape and the amount carried be in such proportion as is sufficient for daily needs.

SIGNATURE CARDS

The teller should memorize his signatures, and the formation, characteristics, and speed of writing. He must see that his signature cards are

kept up to date, and familiarize himself with any cancelations of signatures, changes in, or additions thereto, as well as become acquainted with the signatures of new customers. He must know that the funds are being paid to the person named as payee, and that the latter is properly identified in case he is not known to the bank.

On checks offered for cash or deposit the teller cannot always verify the first indorsement and must depend on the reputation and credit of his customer. With regard to the encashment of checks, many banks instruct their tellers to cash only checks drawn on themselves upon proper identification and checks on other banks only for their customers. All clearing house and transit checks presented by any one other than a responsible depositor must be approved by an officer before being cashed.

Checks payable to companies, lodges, or estates should not be cashed or accepted for the credit of an individual, but, as there are many small companies owned by an individual, the depositor should be questioned and an investigation should be made, either through mercantile agencies or through court records, to verify his statements.

Tellers must, of course, see that all checks are in proper order as to the date and amount, that there are no stop-payment restrictions against the checks, and that there is sufficient amount on deposit to the credit of the maker.

The responsibilities of the teller, or official, in accepting new accounts have already been considered as fully as our limited time will permit.

Exchange tellers, with a few exceptions, operate under the same rules

as paying tellers and receiving tellers. It is advisable for the exchange teller not to exchange any class of check payable to an individual, corporation, or partnership, for cashiers' checks made payable to the same payee, unless the item has the approval of an officer of the bank. One bank in Los Angeles suffered a loss of \$5,000 or \$6,000 through the lack of proper identification of the person presenting the check for conversion. Some banks require identification of the purchaser of drafts or cashiers' checks.

It is most important that a teller should always be alert, courteous, and friendly. A friendly nod, a word of cordial greeting, costs so little effort, yet produces such wonderful results, far beyond the cost of the effort! To cultivate a memory for names requires very little exertion and yet will repay you big dividends all your life in personal improvement, besides making you more effective for the bank. There is nothing people appreciate more than being called by name when they step up to the teller's window or desk. It is seemingly a small thing, yet of tremendous importance in customer relations.

If a teller desires to attain success for his bank and himself, as in other vocations he must proceed with a careful, definite, sound, and efficient schedule as the basis.

"Honour and shame from no condition rise;
Act well your part; there all the honour lies."

Discussion

FRANK E. COBUN (Federal Reserve Bank, Pittsburgh): What is the purpose of having the officers of

the institution okeh the checks that you speak about in particular? I think you spoke about cashiers' checks or customers' checks.

MR. SHEPARD: The reason we require an officer's okeh on the check is that it affords more time for investigation of the item. Tellers frequently are under the handicap of having other customers waiting in line at the window. The particular classes of items that Mr. Cobun has reference to are those where an individual not known to us presents a check for one of our customers as drawee and wants to get a New York exchange or cashier's check. Requiring an officer to pass on it relieves the teller of considerable responsibility, and the officer has an opportunity to get in touch with the maker of the check, possibly by telephone, to see if he has actually issued it.

OSCAR DYKES (Hamilton National Bank, Chattanooga, Tennessee): Did I understand you to say that you require a copy of letters testamentary when account is opened?

MR. SHEPARD: We do in connection with a guardianship.

MR. DYKES: Do you consider it absolutely necessary in opening accounts?

MR. SHEPARD: Not absolutely. If the person opening the account already has a personal account and is well known to us we accept the statement that he has letters testamentary or he exhibits the original; we do not require a certified copy in every instance. Just as a matter of discretion, we get a certified copy on withdrawal.

MR. DYKES: I realize that it is necessary for withdrawing funds, but I cannot see that it is absolutely essential when opening an account. If you know that person, it would not concern the bank so very much whether that man is an administrator or an executor or a trustee.

MR. SHEPARD: It is not so essential in making the deposit, but every deposit of course contemplates ultimate withdrawal, and the logical time to be prepared is at the time the account is opened. It is advisable to have the proper authority given to you for withdrawal at the time the account is opened. However, that might be given to you later.

CHALMERS E. LONES (Security First National Bank, Los Angeles): In opening an account do you allow a fictitious firm name? Do you require a certificate of ownership?

MR. SHEPARD: We make some investigation at the time to ascertain that a partnership exists, but we do not require any definite form as we do with corporations.

MR. LONES: Suppose two people say they are the owners of the Southwest Produce Company. Do you take their word for it?

MR. SHEPARD: If they are well known to us and are known as responsible individuals we accept their word as to the existence of the firm and their authority to check against it.

GEORGE L. GREENUP (National Bank of Commerce, Detroit): In some cities the county clerk records those names using the assumed name. In Detroit it is recorded. We get a copy of that from the county clerk.

Interior Clearings

By FRANK E. COBUN

ASSISTANT CASHIER OF THE PITTSBURGH BRANCH, FEDERAL RESERVE BANK
OF CLEVELAND, PITTSBURGH, PENNSYLVANIA

Address before the Denver Departmental Conference

Mr. Cobun does not merely state that interior check clearing and collection departments need further simplicity in routine, but he suggests definite practical measures by which to bring about this greater efficiency, such as systems by which checks may be traced to their place of origin and positive identification may be supplied at all times, or especially practical methods for handling remittances. In addition, he supplies a chart by which efficiency can be analyzed. Mr. Cobun gives also a list of the Federal Reserve banks and branches with new prefix numbers, chosen according to a numerical system which he has worked out.

Mr. Cobun feels that the advancement of banking institutions toward an ideal of efficiency has been slow, particularly as compared with the advancement of industrial concerns, and that there should be a concerted movement organized for the sole purpose of improving the check clearing and collection system.

WE use the word "clearings" in referring to daily exchanges between associated banks and trust companies of checks, drafts, and other special negotiable instruments, and the payments of balances arising from such exchanges. The word "interior" is used in referring to banks in large centers. Checks constitute the major part of clearing and collection items, and my paper will be confined to the description of details and the analysis of departmental routine in handling checks received by a check clearing and collection department of a Federal Reserve bank. It is my aim to show that interior check clearing and collection departments have not reached an ideal stage in departmental routine; that we must have more efficiency to be ideal. Simplicity in routine is es-

sential to save time and labor. Industrial problems are measured by efficiency, and check clearing and collection departments will eventually be measured in a like manner. True conditions and elements that produce efficiency are determined by analysis.

MAIL DEPARTMENT OF FEDERAL RESERVE BANKS

The mail department of Federal Reserve banks receives checks from member and non-member clearing banks in its own district, from member and non-member clearing banks of other districts, and from other Federal Reserve banks, and delivers checks with descriptive letters to the block clerks in the check collection department. Other checks functioned by other departments of the

Federal Reserve bank are delivered to the general proof department. The general proof department of the Pittsburgh branch of the Federal Reserve Bank of Cleveland is dovetailed with the check collection department, and receives credits and distributes checks from departments other than the mail department. The general proof clerk, with one assistant, in addition to other duties has charge of the check collection department proofs, and also blocks and proves checks received from departments. The department is assigned identification number 23.

TRACING SYSTEMS

It is of major importance in a check collection department to organize in such a way that it will not be difficult to trace checks to place of origin, and to be able to supply positive identification at all times. Banks sending checks to Federal Reserve banks use the following systems for this purpose:

1. The alphabetical code system: this provides a numerical code for identifying the last indorser who has not been assigned a transit number. In case the transit clerk wishes to identify an item, he has the amount, the date, and the numerical designation on which to base his identification.

2. The block system: under this plan, the block number, the amount of the transit item, and its time in transit supply positive identification.

3. The auxiliary sheet method: the plan is used very extensively because the auxiliary sheet eliminates all further handling of the transit letters after they have been written, and because it also provides a numerical indorsement identification of every item handled.

4. The combination plan: this plan is used by banks that prefer to write

in the names of last indorsers to whom transit numbers have not been assigned.

5. The Recordak: this is a photostat of the face of the check. The two numbers photographed with the check are the bank's code number and the Recordak serial number, useful in identification and filing. If necessary, checks received by the check collection department from the general proof department are traced by block number via the general proof clerk block sheets to department of origin, where records are found in detail.

We use the block system for tracing checks, but do not use the block number on outgoing cash letters. In this connection, I wish to state that the elimination of the use of block numbers on outgoing cash letters is accomplished by tracing through the block number on batch sheets to description on incoming cash letters and to department records. Incoming letters, Recordak films, and department records serve as positive identification.

Member banks are requested in the preparation of their letters to sort their checks in accordance with a time schedule with a separate letter and a total for each separate time group.

Cash letters and remittance letters and accompanying checks and drafts are received by the block clerks. The letters and checks are first sorted into three divisions: (1) cash letters and checks from Federal Reserve banks and branches, and from member banks located in other Federal Reserve districts; (2) cash letters and checks received from member banks in our own district; (3) remittance letters, drafts, and return checks received from member and non-member banks in our own district in payment of cash letters. These letters are termed "remittance" to dis-

tinguish them from letters received for credit, which letters are referred to as "cash letters."

Cash letters in divisions No. 1 and 2 are then time-stamped, at which time a secondary sort is made into two divisions: (1) checks payable through the Pittsburgh Clearing House; (2) checks to be sent for collection through the mail (for convenience and brevity, termed "country checks"). Letters and return checks in group No. 3 are delivered to the remittance clerk. Stamps reading "immediate," "one-day," "two-day," and so forth, to indicate classification and the available date for credit to the accounting department are used by the block clerks. Block numbers of 51 to 150 are used for clearing house checks, of 201 to 450 for country checks, and of higher numbers for blocks made up of special letters. The proper classification stamp and the initials of the block clerk are placed on the face of each cash letter. The checks are worked into blocks of 300 to 500 checks each, and the block number is placed on the back of each letter in the block. Some cash letters consist of more than the ordinary number of checks in a block and have to be split into several blocks. When a split is necessary, a total slip is substituted for the letters; the total of the letter sheets that comprise each block is run on a batch sheet, a subtotal being taken after each block and then a recapitulation made. The American Bankers Association numerical number of the sending bank is placed after the recapitulation. The batch sheets of all split letters are sent to the accounting department with the letters. The checks with letters, or checks with total slips are

delivered to the indorsers. After the checks have been indorsed, they are placed with the letters or with total slips, and are delivered to sorters.

COUNTRY CHECK AND CLEARING HOUSE SORTERS

Country check sorters are provided with canary-colored batch sheets, to be used with blocks accompanied by cash letters; with green batch sheets, to be used with split blocks accompanied by total slips; also with sets of route tickets with the name of each division printed in the upper center of the ticket. Upon receipt of a block of checks, the letters are examined to see that they are properly addressed. The checks are sorted into twenty-three divisions and counted as they are sorted. The block number is stamped on the batch sheet and on the route ticket. The number of checks in a block and the name of the sorter are placed on the batch sheet. Each sorter keeps a record of the batch sheet number and the number of checks sorted. The route ticket is then placed on each division. The divisions are gathered in order, the batch sheet and letters or total are banded around the checks, and the batch is then sent to the adding machine listers.

Clearing house sorters are provided with white batch sheets, to be used with blocks accompanied by letters, and with pink batch sheets, for use with split blocks accompanied by total slips; also with sets of route tickets, with the name and bank number of each clearing house bank printed on the upper part of the ticket. The clearing house sorters follow exactly the same procedure as the country sorters, excepting that the

block number is not needed and is not placed on the route ticket.

CLEARING HOUSE AND COUNTRY BATCH LISTERS

We use the duplex adding machine, with tally feed and check counter attachments, for listing, proving, and counting checks in clearing house batches. The letters are listed on the batch sheet and on the tally roll tape, and the tape is attached to the letters. The A. B. A. numerical number of each division is printed on the batch sheet and on the tally roll tape by use of the non-add key before checks are listed. When the checks are listed, the route ticket is inserted in the adding machine behind the ribbon before the division total is taken, and the subtotal placed thereon. The total of each division is printed on the batch sheet and on the tally roll tape. The tally roll tape is then torn off and banded with the checks and route tickets of each division. When the batch listing is completed, the number count of the sorter is verified by the adding machine counter and the batch sheet is banded around the division and letters and sent to the checkers.

The procedure in listing batches is exactly the same as that of clearing house batch listing, excepting that the tally roll tape is not used when the checks are listed on the batch sheet.

The checkers compare grand totals of checks against grand totals of letters, to see if the batch is in balance; insert the A. B. A. number of depositing banks opposite amount of letters on batch sheet; and find errors in listing by block number of batch and name of batch sheet lister. The record of errors is sent to the statistical

clerk and the batch is then given to the distributor.

There are two distributors, one for clearing house batches and the other for country batches.

1. The clearing house distributor sorts and accumulates divisions to clearing banks, distributes checks to division listers, and lists total of clearing house batch sheets. Letters with tape attached are delivered to the accounting department, and the batch sheets are grouped, dated, and filed.

2. The country distributor sorts, accumulates, and distributes checks to secondary sorters and listers. These sorters and listers are referred to as "case operators." Letters with tape attached are sent to the accounting department; the batch sheets are then grouped, dated, and filed.

CLEARING HOUSE DIVISION LISTER

The clearing house division lister detaches the route tickets and runs the total of the route tickets on the adding machine tape. The totals on the tally roll tape are run on a small batch sheet, and the total is proved against the grand total of route tickets. The grand totals of each division are listed on a statement to the clearing house manager, totaled, balanced against the clearing house distributor's grand total, and sent with the checks to the clearing house. Settlement is made by drafts on the Federal Reserve Bank of Cleveland, and the drafts are delivered to the general proof department.

COUNTRY DIVISION SECONDARY SORTERS

The country division secondary

sorters and listers are referred to as case operators and are separated into two classes: (1) clerks sorting and listing checks to member and non-member banks in our own district; (2) clerks sorting and listing checks to Federal Reserve banks and branches of other districts.

In classification 1, the case operators sort checks to banks represented in the division and list checks, by amounts only, on cash letter forms addressed to the banks on which the checks are drawn. Our indorsers on checks of \$500 or over are described by numerical number by use of the non-add key. For example, 8.12 with the non-add key indicates that the indorser is 8-12.

In classification 2, the case operators sort in accordance with the interdistrict collection list, address letters to banks, and list checks by the numerical number of the drawee bank and the amount, and also describe by numerical number the name of indorsing bank on checks of \$500 or over.

Route tickets are accumulated as the checks are sorted. The total of the route tickets is then listed on adding machine tape and delivered to the country check division proof. The total is used by the case operators as proof against the total of letters in the division. A record is kept by each case operator of the number of checks sorted, the number of checks listed, the number of missorted checks received, and the time spent on work other than sorting or listing. Records of missorted checks are kept by block number and amount of batch in which received, and are delivered daily to the statistical clerk. When a case is balanced, a rubber band is placed around

each batch of checks, and these, with other enclosures, are placed in an envelope addressed to the collecting bank. The envelopes are sealed by the case operators and delivered to the mail department.

Missorted checks are run twice on adding machine tape by the case operator, one record being made for our own use and one for the distributor. They are then collected by the distributors for resorting and batching. The amount of these checks is sent to the general proof for deduction from the grand total of country checks and for deduction by the country check proof clerk from the division from which they were received.

REMITTANCES

Remittances are delivered to remittance clerks. Letters containing only clearing house drafts are separated from other letters and blocked into a batch of about 150 drafts. An open block number is assigned to the block. Letters and drafts are listed to prove, and the A. B. A. numbers of the banks written on the batch sheet opposite the letter amounts. A total slip is placed with the drafts and sent to the indorsers. Letters containing return checks and drafts are sorted into five divisions, as follows: (1) clearing house returns; (2) country returns; (3) clearing house drafts; (4) country reforward checks; (5) general proof (drafts drawn on Federal Reserve Bank of Cleveland). The letters and checks are listed on a batch sheet and proved. The A. B. A. numerical numbers of the banks are written on the batch sheet opposite the letter amounts, the indorsements

on return items are circled, total slips placed on each division, and distributed. All remittance batch sheets and letters, together with general proof division checks, are then delivered to general proof department. Letters are delivered to remittance division by the general proof department, where they are used to pay off unpaid letters. We use the pull system and stamp each letter with a paid stamp on date the letter is pulled. The letters are then filed with the remittance form by name of bank. The unpaid letters are listed on a batch sheet and balanced against the control ledger figures. A control account is kept by the branch, and this control figure is obtained by the remittance clerks from the general proof department.

RETURN CHECK DIVISION

The return check division receives return checks from two sources, namely, from remittance division and from the general proof. The general proof division receives return checks from the note teller and from the incoming clearings division. The return item division is dovetailed with the remittance division. The clerks in each division assist one another at times of peak loads. For example, the remittances received are extremely heavy prior to 10:00 a. m. The clearing house drafts and the clearing house return checks must be cleared. The volume is too heavy for the remittance clerks, but, with the help of the return item clerks, they accomplish results. Return slips are attached to protested checks. The slip is addressed to our previous indorsing bank and the reason for return written thereon. The return

clerks then make up a special block to prove checks received from the remittance division. The checks are then sorted into divisions, twelve Federals, twenty-five Federal Reserve branches, Cleveland direct, Cincinnati direct, and others. The batch sheets are sent to the general proof department. Country return checks are then listed on letters addressed to prior indorsing banks and returned by mail. The totals of the letters are grouped, recapitulation taken, and balanced with the general proof total.

INCOMING CLEARING HOUSE

Most of the government checks and post office money orders are received by us through the clearance at 10:00 a. m. Checks received through the morning clearance are sorted into three divisions: (1) government checks; (2) post office money orders; (3) return checks and other miscellaneous checks. Government checks are sorted into classifications such as pensions, war risk, interest, and others. The three divisions are listed and proved against the totals on the incoming clearing house slips, after which government checks are sent, with tape total attached, to the government check division. Post office money orders are sent to the post office. Group 3 (return items and miscellaneous) is delivered to the general proof clerk, with total slip showing the amount of each group and the total for the entire group. Post office money orders are settled by warrant drawn on the Treasurer of the United States. This warrant is received by the general proof department.

Government checks, when received by the government check department,

are already sorted by classification as previously described. They are then sorted by symbol number, check number, and amounts, and listed in like manner. A recapitulation is then taken by symbols, classified as to ledger sections and ledger section totals, then grouped and charged by the general proof clerk against the account of the Treasurer of the United States.

COUNTRY CHECK COLLECTION DIVISION PROOF

The accounting department accumulates the letter totals of the batch sheet, adding machine tapes under three totals: (1) clearing checks; (2) country checks; (3) government checks.

The aggregate of the three divisions is used as a proof against the total amount of letters. The accounting proof is delivered to the general proof department, where it is used as a proof against the aggregate of checks handled by clearing house division, country check division, and government checks. The total of the country check division as shown by the accounting department is used as a proof against the total of the route tickets delivered by the case operators of the country division to the country division proof clerk. The country check division proof is extremely simple and takes only thirty minutes of one clerk's time to charge the division totals, make deductions for missorts, and balance with general proof figures.

The efficiency record problem on first thought seems extremely difficult. However, the foregoing analysis of units, supplemented by an additional analysis of performance of the clerks

in the units, and our decision to use weekly credits and a forty-five-hour per week basis, produced an effective plan. The initial details in connection with the analysis are elaborate, but, after the plan was set up, the work in connection with the plan was very simple. The plan will be mentioned in brief to show that efficiencies are determined by analysis.

After analysis, credits and deductions from credits were determined by the following method:

BASIS

Time

Forty-five hours per week

Time Out

Work not included in the plan

Work accomplished in less time than
45 hours

Credits

1.500 for every 1,000 checks listed
(batches or case)
1.000 for every 1,000 checks sorted

Credits for Exceptions

(Country division, secondary sorters,
and lists to Federal
Reserve banks)

6.000 for every 1,000 checks listed
on case
1.500 for every 1,000 checks sorted
to case

Deductions

.150 for every error on batches
looked back by checkers
.150 for every missort in country
batches
.300 for every "sent wrong" check
(case or clearing house)

Case operators and batch listers keep their own records, except for the deductions. Records are then given to the statistical clerk, who spends about two hours each week in grouping. The maximum number of credits is 108 for the week.

A NUMERICAL SYSTEM

The Federal Reserve check clearing and collection departments handle approximately for member banks each year a total of 900,000,000 checks, and the total is increasing steadily each year. Mention has been made of the fact that check clearing and collection department systems have not reached an ideal stage. Description of checks is a paramount necessity, and the various systems mentioned herein are devised to reduce descriptive work and thereby save time and labor. Time and labor saving was the purpose of the originators of the Rand McNally numerical system. It is my belief, however, that the present numerical system should be revised to conform to Federal Reserve districts and zones.

In the Rand McNally and Company numerical system, excluding the prefix number for Alaska, we use forty-nine prefix numbers for large cities, and forty-seven prefix numbers for states, or a total of ninety-six prefix numbers. The Federal Reserve districts created under the Federal Reserve Act are only twelve, and each district is designated by number. There are twenty-five Federal Reserve branches, or a total of only thirty-seven Federal Reserve banks and branches. It seems to me that it would be possible to use as prefix numbers for banks in each Federal Reserve bank collecting zone, the

number designated to each Federal Reserve bank, and then designate by same prefix number the banks in the branch zones, excepting that the branch zone prefix number would be supplemented by letter designation. I would suggest that the letters assigned the branch zone prefix numbers start with the letter M, so that there would not be confusion between letters used on Federal Reserve notes, and letters used with prefix numbers on checks. Prefix numbers assigned to banks in Federal Reserve district zones and to Federal Reserve branch zones, would then be as follows:

LIST OF FEDERAL RESERVE BANKS AND BRANCHES

	<i>Proposed Prefix Numbers</i>
BOSTON	1
NEW YORK	2
Buffalo branch	2 M
PHILADELPHIA	3
CLEVELAND	4
Cincinnati branch	4 M
Pittsburgh branch	4 N
RICHMOND	5
Baltimore branch	5 M
Charlotte branch	5 N
ATLANTA	6
New Orleans branch	6 M
Jacksonville branch	6 N
Birmingham branch	6 O
Nashville branch	6 P
CHICAGO	7
Detroit branch	7 M
ST. LOUIS	8
Louisville branch	8 M
Memphis branch	8 N
Little Rock branch	8 O
MINNEAPOLIS	9
Helena branch	9 M
KANSAS CITY	10
Omaha branch	10 M
Denver branch	10 N
Oklahoma City branch	10 O
DALLAS	11
El Paso branch	11 M
Houston branch	11 N
San Antonio branch	11 O

SAN FRANCISCO	12	
Los Angeles branch	12	M
Portland branch	12	N
Salt Lake City branch	12	O
Seattle branch	12	P
Spokane branch	12	Q

PREFIX AND SUFFIX NUMBERS

The suffix number could be assigned to banks in the different zones in alphabetical order of name, or blocks of numbers could be assigned to counties in a zone in alphabetical order. Then, from the block, numbers could be selected for each bank. Low suffix numbers could be assigned to banks in large centers. Banks not appearing on the interdistrict collection list of the Federal Reserve banks could be assigned special numbers, or could retain their present numbers. To illustrate the advantages of the proposed plan as compared to the present plan, we will use as an example the Citizens National Bank, Waynesboro, Pennsylvania, whose present numerical number is 60-602, and the First National Bank and Trust Company, Waynesburg, Pennsylvania, whose present numerical number is 60-803. Waynesboro is located in the Philadelphia Federal Reserve District No. 3, while Waynesburg is located in the Pittsburgh branch zone of the Cleveland Federal Reserve District No. 4. We frequently receive in error, from member banks of other districts, checks drawn on Waynesboro, Pennsylvania, banks, and in a few instances, the sending member bank has been embarrassed on account of delay in handling. It is my opinion that the forwarding banks confuse this name with Waynesburg, Pennsylvania, in the Pittsburgh zone. If the proposed prefix numbers and

present suffix numbers were used for these two banks, we should have Citizens National Bank, Waynesboro, Pennsylvania, 3-602, and First National Bank, Waynesburg, Pennsylvania, 4 N-803. The prefix would designate the Federal Reserve bank through which the check is collected and there would be hardly a chance of misrouting a Waynesboro check to Pittsburgh, since the prefix number plainly indicates District No. 3. Under this plan, a check on Waynesboro, Pennsylvania, sent to the Federal Reserve Bank of Philadelphia, would not be described as 3-602, but simply as 602, while a check on Waynesburg, sent to the Pittsburgh branch, would be described as 803. Under the present plan, the description is usually 60-602 or 60-803. Simplification is a saver of time and labor, and by a change in designated numbers as previously mentioned, routing description and sorting would be simplified. Under the proposed plan, it would not be necessary to refer to the interdistrict collection list, and sorting would be speeded. If the sorting alone is speeded on 900,000,000 checks yearly, certainly the revised plan as suggested would save a great amount of time. I am positive that a number of other advantages will accrue if a revision is made. For instance, checks can then be sorted by number instead of by name of bank.

CARD CHECKS

It has been brought to my attention recently that there are passing through the bank card checks used and punched to indicate number and amount of checks, and so forth.

Upon investigating, I find that the card check is used principally by a few industrial concerns for payroll purposes, but upon further investigation I find that machines in connection with the punching, sorting, and listing are used by a great number of industrial concerns in our district for payroll purposes. A few days ago I saw the work these machines would do, and I have no doubt that they could be used to save the check clearing and collection department's work to a great extent, provided standard size in checks and standards in punching checks were used by banks. The machines will sort standard-sized card checks at the rate of four hundred a minute per column. Numerical numbers run as high as four figures, which would take four sorts at the rate of one hundred checks per minute. Straight addition work is performed at the rate of one hundred and fifty checks per minute, and listing at the rate of seventy-five per minute. If used in connection with the numerical revision as mentioned, I am convinced that the plan would be a great advance in check clearing and collection.

In conclusion, I cannot help but feel that our advancement toward the ideal has been slow, particularly when this advancement is compared with the advancement of industrial concerns, and I also feel that there should be a concerted movement organized for the sole purpose of improving the check clearing and collection system. There is work to do and that work should be done now.

Discussion

JAMES A. POWELL (Federal Title & Trust Co., Union Falls,

Pennsylvania): Mr. Cobun, do you not think that large cities, particularly New York, would object to losing their identifying transit number?

MR. COBUN: I see a gentleman from New York here—Mr. Hill—and I think Mr. Hill will agree with me when I say New York is big enough to recognize a good thing when it sees it. When the Federal Reserve Bank of New York was given No. 2, the scope of the thing was so large that you never heard a thing about No. 2; I think we would not have any objection from New York in any way, provided it thought the plan was feasible.

EDGAR L. UHLIK (Security First National Bank, Los Angeles): In connection with this proposed change of the numerical system, many of our banks are using the Burroughs transit machine; how would you insert the alphabetical designation in that Burroughs transit machine?

MR. COBUN: We will take an example. We will say the check is drawn on the Pittsburgh branch of the Federal Reserve Bank of Cleveland, and the check is held by a clerk in the transit department of your bank in Los Angeles. The object of routing that check is to route it to the Pittsburgh branch, and the minute the check is received the clerk knows that by the prefix "No. 4—dash—whatever the suffix may be," it is to go to the Pittsburgh branch. There isn't any question about it.

To get it into the machine you do not describe it further than on the letter going to the Pittsburgh branch, for every item in that is routed to the Pittsburgh branch. There is no description other than the numerical number of the bank on which the item is drawn.

MR. UHLIK: Suppose the banks do not use the Federal Reserve bank but use the correspondent bank relations. If that type of A. B. A. number is on the check and we use the correspondent bank relations, it makes it almost obligatory to use the Federal Reserve bank system in order to use that number. For instance, we use a correspondent bank in Pittsburgh, and if the A. B. A. designation with the alphabetical insertion is on that check, it becomes the designation in nationwide use; since we are writing our letter to our correspondent bank in Pittsburgh in lieu of the Federal Reserve bank, we could not designate those checks very well.

MR. COBUN: I do not see why.

MR. UHLIK: Because we will split at Philadelphia, Pittsburgh, Buffalo, Cleveland, and Cincinnati. We use all our correspondent banks at those points.

MR. COBUN: Your letter would be addressed to the correspondent bank in Pittsburgh. We will say, for example, it would be No. — (a national bank). Would you have to state in your letter any designation other than the numerical number of the bank on which it is drawn in Pittsburgh?

MR. UHLIK: Yes. We send some eastern Ohio items to the Mellon National Bank at Pittsburgh. We would have a conflict of the numbers because we could not put the Federal Reserve district classification 6 in front of the designation M or N or O for the Ohio number. We would show 6-0-2, which is indicative of an Ohio bank, and we would possibly have 6-0-2, which is indicative of a Pennsylvania bank. The two numbers would conflict.

THE CHAIRMAN: I think I see the

answer. If the system were adopted it would mean that those banks sending items to correspondent banks would, if they used the plan you have outlined, namely, including in a cash letter only items payable within that certain zone, have to restrict their sendings to a separate cash letter for items in each Federal Reserve zone. So that the heading of the letter might indicate that this is a letter containing items payable only to the Pittsburgh zone, in other words, 6-N, and then only listing the suffix number of the bank. Then if you had letters payable to another zone you would have to make a separate letter for those items.

I think as a matter of general practice that larger banks in routing to correspondents now separate the commercial checks from the out of town checks into two letters as a matter of convenience. So there might be a possibility that the plan would cause additional sortings for those banks that use correspondents and possibly be some hardship to the smaller banks, that is, to the bank that is accustomed to taking all its checks and putting them in one letter and sending it to a correspondent bank. But those are things that I imagine would be worked out.

THOMAS DUNCAN (City National Bank, Knoxville, Tennessee): We have quite a different problem from the Federal Reserve bank in the larger cities. We receive cash letters on a number of country banks that are not members of the Federal Reserve System. They have a large number of items that are on out of town banks. It seems to me that these smaller banks are going to have quite a job using the numerical system. They dump all their items on us.

MR. COBUN: I think I explained that, by saying that a check drawn on a non-par bank would probably have a special number assigned to the bank. Or, if no number were assigned, then it would probably retain its present numerical number. If it retained the present numerical number and you were given a check on a non-par bank, you would have to look it up regardless of whether it had a special number or whether it retained its present number, or no matter what you would do, for it would not be listed in the interdistrict collection par book. The plan is to assign numbers for routing purposes more than for anything else.

H. H. CONKLIN (Federal Reserve Bank, Chicago): I should like to ask Mr. Cobun if he does not keep a record of his block numbers on his outgoing cash letters. Suppose he has a lost cash letter. How does he go about identifying who received the items?

MR. COBUN: We do not show the block on outgoing letters. We use the block system, however, and we trace an item through reference made to the letter itself. The position of the check in the letter indicates the position of the batch sheet, with the number of the batch sheets that have gone through for the day. The very fact that the item is in a section locates it immediately on the batch

sheet and from the batch sheet we trace it to the letter on that batch sheet to its origin.

MR. CONKLIN: I think you have the same system we have. The girl sending out the country checks keeps them in the same order as the block sheet. She has possibly three separate runs. If it is the first item going out on the cash letter, it would be the first item on the block sheet.

MR. COBUN: That is exactly the same thing. I will say, however, in connection with that, that the Federal Reserve bank could not use the system to advantage if the member banks of the Federal Reserve System did not do likewise, because if they failed to describe the items on their letters, our system would be practically nil and would have to be abolished.

MR. CONKLIN: That is our trouble, too.

WILLIAM THOELE (First National Bank, St. Paul): I just wondered how you traced return items that had not been indorsed.

MR. COBUN: We keep special batch sheets for all return items. The items come through the various sources and it is a very easy matter to trace them because there are practically only two batch sheets from which to trace, the total number of items being probably about a thousand per day.

Some Clearing Problems

By GEORGE L. GREENUP

ASSISTANT CASHIER OF THE NATIONAL BANK OF COMMERCE OF DETROIT,
DETROIT, MICHIGAN

Address before the Denver Departmental Conference

Mr. Greenup here reports the findings of his thorough and extended investigation of the rules and methods of operation of the clearing house associations in some of the large cities of the United States.

To facilitate the distribution of checks, the clearing house associations of New York, Cleveland, and Detroit have instituted the so-called midnight exchange, and it is through this exchange that the greatest volume of checks is handled. Mr. Greenup explains in detail the operation of the midnight exchange in Detroit.

The problem of a fair and expeditious exchange of return items has been solved in New York City by dividing the city into two zones or districts, the central zone and the outlying zone. This plan also Mr. Greenup describes in detail, as well as the problem of "not sufficient funds" checks; he discusses, too, the coupon exchange, which has been so successfully conducted in New York. In view of the great volume of coupons being handled by banks at the present time, and the inconvenience occasioned by presenting them by hand to the paying bank, the coupon exchange seems to be the solution of a pressing problem.

TO present properly and intelligently the problems indicated in the title of this article, a thorough and extended investigation of the rules and methods of operation of the clearing house associations in some of the large cities of the United States was necessary. This investigation revealed that as a result of the rapid expansion of branch banking in many of these cities in recent years, a number of problems had been created, the solution of which required some changes from the old established order of clearing exchanges.

In the past, when the majority of banks were grouped in the main business sections of the cities, two clearing exchanges were sufficient, the regular morning exchange, usually at 10:00 a. m., and the return item ex-

change at 2:30 p. m. Now with branch banks within a radius of anywhere from one to thirty miles from the financial district, it is obviously difficult to distribute checks received in the morning clearing, to these branch offices, and for them to return unpaid items during the regular banking hours.

THE MIDNIGHT EXCHANGE

To facilitate the distribution of checks, the clearing house associations of New York, Cleveland, and Detroit have instituted the so-called midnight exchange, and it is through this exchange that the greatest volume of checks is handled. As this midnight exchange of checks is not general throughout the country, however, I

believe it may be opportune to explain how it is operated in Detroit at the present time.

The clearing house is open to receive packages containing all items eligible for clearance, from 3:00 p. m. until 1:30 a. m. As all items originating in branches of member banks must be cleared through this exchange, messengers from the branches deliver to their main offices, usually before 6:00 p. m., all checks, properly sorted in sealed envelopes, plainly marked with total of contents and with clearing house number of member bank on which checks are drawn.

Clerks in the transit department then assemble these, with all main office clearing items, into packages, marking the outer covering of each package with the clearing house number of the receiving banks and the total amount of items enclosed therein. Upon delivery of these packages to the clearing house, the representative there signs a receipt for all of them, the original of which is retained by the delivering bank and a duplicate by the clearing house association. The amounts of the items contained in the packages are charged against the several other members through the 10:00 a. m. settlement exchange the same day. At any time after 1:45 a. m. and before 9:00 a. m. representatives of members may call for packages of items drawn on them, signing a proper receipt, which is retained by the clearing house association. With an early morning shift working in the transit department, this exchange has been of material assistance in the early distribution of checks to the branches.

The problem of a fair and expeditious exchange of return items has

been solved in New York by dividing the city into two zones or districts, the central zone and the outlying zone. Banks located in the central zone must return unpaid items through the return item exchange held at 3:00 p. m., but branches of members located in the outlying zone have the privilege of returning dishonored items, of less than \$5,000, through the midnight exchange, provided that they notify their principal office by telephone of all such items being returned. This enables the main office to comply with the clearing house regulation, which requires that an itemized list of all "not good" items being returned through the night exchange must be delivered to the presenting bank at the 3:00 p. m. clearance. All return items over \$5,000 from the outlying branches must be sent back by messenger so as to reach the indorsing bank not later than 4:00 p. m. the same day.

San Francisco also has instituted the zone system for the handling of return items. Banks that have branch offices located in the outlying districts of the city are permitted to return unpaid items drawn on these branches at a special reclamation exchange held at 4:00 p. m.

In Cleveland and Detroit the rules for handling return items from branches are very similar. In both of these cities, where a great many branch banks are maintained, many of them in outlying sections of the city, dishonored items are returned to the main offices and cleared through the 1:30 a. m. exchange. Branch banks in Cleveland, however, are required to notify the indorsing bank by telephone before 3:00 p. m. of the dishonor of any items over \$100.

"NOT SUFFICIENT FUNDS"

The great number of checks being returned for the reason "not sufficient funds" constitutes another problem which the clearing house associations have had to meet. In an effort to minimize the number of these checks, a penalty charge against the account of the drawer has been instituted in some cities.

Three years ago the Detroit Clearing House Association established this rule, fixing the amount of the charge at twenty-five cents for each check drawn against a commercial account and returned for "insufficient funds" or "drawn against uncollected funds." During the first few months that the rule was in force, a decline in the number of these checks was noted, but the totals for the years 1928 and 1929 showed a steady increase. In view of this fact, the Clearing House Association decided to increase the penalty charge to fifty cents, effective June first of this year. It will be interesting to note whether or not this increase has the desired effect.

For the information of its member banks, the St. Louis Clearing House each day compiles a list of the names of all drawers of checks returned by member banks, for the reason "no account," giving a full description of each item. The value of such a list, placed before every teller daily, can readily be seen.

THE COUPON EXCHANGE

Before closing this presentation of clearing problems, I believe it will be appropriate to say a few words about the coupon exchange, which has been so successfully conducted in New

York. The exchange is held daily at 9:15 a. m., and is conducted in a manner very similar to the regular check exchanges. Receipts given members for packages delivered through this exchange are treated as due bills and charged through the 10:00 a. m. clearance the following day. Unpaid coupons are either returned by hand the same day or through the coupon exchange the following day. Members who participate in this exchange are obliged, each month, to furnish the clearing house with a list of coupons due and payable, which such participant pays. The clearing house compiles these lists in alphabetical order and distributes copies to all members. In view of the great volume of coupons being handled by banks at the present time, and the inconvenience occasioned by presenting them by hand to the paying bank, the coupon exchange seems to be the solution of this problem.

Discussion

EDGAR L. UHLIK (Security First National Bank, Los Angeles): In your mention of the coupon exchange—how do you incorporate the building and loan associations which pay their own coupons, or the mortgage associations, since not all coupons are payable at the banks?

MR. GREENUP: That is a good question, for that is just what is preventing the Clearing House Association of Detroit from having the coupon exchange. We are very anxious to have it, but we will have to get the building and loan associations and also the trust companies to participate in the exchange.

CHARLES HEMMINGSEN (First

Seattle Dexter Horton National Bank, Seattle): Regarding your branches in the outlying districts, do you handle those items like clearing items—that is, do you collect by messenger?

MR. GREENUP: All those branches clear through the head office and it, in turn, presents the items to the clearing house, and vice versa. When the checks are returned, they all go to the main office.

MR. HEMMINGSEN: How do you protect yourselves in case of robbery? You don't keep a record.

MR. GREENUP: Yes, we have a record at the branches. It is made on the tellers' daily blotter. The transit items are written up on the transit letter.

THE CHAIRMAN: How do you get the checks out to the branches?

MR. GREENUP: We have messengers now. At the present time each branch has a messenger, and, if possible, if the banks are in the same locality, one messenger will handle the locality. At the present time we are planning to use automobiles. Some of the branches do that already. We will have two or three cars deliver the checks every morning and pick them up at night.

THE CHAIRMAN: Have you ever tried motorcycles?

MR. GREENUP: We should like to do that.

MR. HEMMINGSEN: If we had ten outlying branches, and if we kept no record of the indorsers, is there any insurance protection that we could get?

MR. GREENUP: Yes, there is. We have such a policy.

MR. UHLIK: Los Angeles has a system in making delivery of checks whereby, after the parent bank pre-

pares the various segregations to its own branches, those certain segregations are then delivered back to the Los Angeles Clearing House Association, where they are combined or sorted into certain routes and are delivered by taxicabs direct to all banks in that route. The Los Angeles Clearing House prorates the expense of a blanket policy covering loss and prorates the expense of the taxicabs.

MR. GREENUP: That is very interesting.

THE CHAIRMAN: That has consolidated and prorated expense for some four or five banks, each of which is independently operating a complete system that duplicates the system of the other.

DON CROULEY (Northwestern National Bank, Minneapolis): Doesn't having your midnight exchange of return items necessitate a one day's delay in the return of those items? If the items are subject to protest from the indorsing bank or the paying bank—

MR. GREENUP: Yes, that is right. It is not one day's delivery. You get the checks the same day that you would have got them, had they been cleared through the regular 10:00 a. m. clearance.

Suppose that on June 18 we accepted a check at a branch. That check would be delivered that same night at the main office and at 11:30 a. m. the following morning. We never did present clearing house checks the same day that we received them. Did you, Mr. Smith?

THE CHAIRMAN: No. At one time they were not accepted through the clearing, and at another time we accepted through the clearing, but we had our own problem in trying to get them paid.

MR. CROULEY: It is our experience in Minneapolis, and I believe it is a rule, that all items coming in from country bank correspondents must be presented for payment; if they are not paid, they must be returned the same day and protested according to instructions. That takes into consideration all banks in Minneapolis, whether they are outlying or city banks. I wondered whether the rule held true.

MR. GREENUP: That is true of returned checks. The checks that are returned by the branches are not returned until the next day. The return checks from the main office must be returned about 3:00 p. m. Branch checks are sent through the 1:30 a. m. clearance and are not returned until the next day.

THE CHAIRMAN: Do you recall how you meet that in Los Angeles?

MR. UHLIK: The city became so large that it was impossible to make presentation the same day the items were received. The mail conditions entered into that. The deposit conditions entered into it. They changed the clearing house rules in our situation to provide three distinct zones in the city. Our problem was very similar to yours in that the city covered such a very large area. One zone, of course, is the metropolitan district comprising a radius of about a million square feet at certain intersection points. Zone two possesses a very flexible boundary line possibly eight miles out. Zone three is composed only of those very outlying branches which could not be tied in to any sort of delivery route whatsoever, because of their isolated locations, and their scarcity.

Our return item situation is very similar to yours. Zone one items are

returned the same day; in fact, we have two return item clearances each day for zone one. We have one return item clearance for zone two district and that is at seven-thirty the following morning because the branches in the outlying locations cannot get those items posted until some time after three or four o'clock. They don't get them until ten or eleven o'clock and it takes until three or four to post them. At that time the major banks in the city are starting to close out their work. So messengers, in bringing in new business, also bring in the return items at the same time to the parent office. The parent office then sorts them according to the parent indorsing bank in the metropolitan district, and those are cleared at seven-thirty o'clock in the morning, at the same time that the new exchange starts for the next zone two clearance.

MR. GREENUP: That is similar to the midnight clearance.

THE CHAIRMAN: Does the Federal Reserve bank make any difference as to zone one and zone two items?

MR. UHLIK: I don't know. I cannot answer that.

THE CHAIRMAN: No. The Federal Reserve bank makes no distinction. The Federal Reserve bank takes all those items as immediately available.

I should like to discuss briefly a slight difference in our system with regard to the handling of these clearings within a city, which I think ought to be of some interest to you.

We operate more than one branch in Los Angeles and San Francisco and in a number of other cities in California, and we have devised a plan for getting the checks from the

branch into the central offices as rapidly as possible and at intervals during the day in order to prevent the checks from accumulating in the branches until a certain time of day and then all piling up at the head office at the close of business.

We term it the interbranch blotter system. I take it that you are all familiar with the method by which a receiving teller's batch blotter is run and proved, and the items distributed to the various departments of the branch. We use in a branch, a blotter that is similar to that blotter; in fact, it differs only in its color, and it is run in duplicate. In addition to the ordinary sortings that a batch proof would have, this has the items that are to go outside of that particular branch divided into certain sortings. In other words, there will be in those sortings all the checks payable at the other branches of the bank within the same city. There will be a sorting of items payable at other branches outside the city. There will be a sorting of clearing house and transit checks. Then there will be a sorting for miscellaneous things, general ledger entries, cashiers' checks, entries for bank accounts, and so on.

The batch proof clerk in the bank, when he runs a batch proof with these various sortings, takes the duplicate copy of that batch proof and wraps it around the items in that division of it that goes outside of the bank. Those batch proofs are picked up from the branches hourly during the day, and taken into the head office by messengers who are operating on regular schedules.

I made a reference to motorcycles a while ago. We used motorcycles and are now using automobiles. We

find that the type of man driving a motorcycle is different from the type of individual driving an automobile. You have too many claims for damages with the man who drives a motorcycle. We find that the automobile is more satisfactory, although it does increase the parking problem a little.

You see what this system accomplishes. It eliminates in the branch the duplication of effort which would be made if the batch proofs were run and then had to be distributed through a distribution and clearance, and then the cash letters and clearings listed and then delivered either to the head office or to the clearing house. The work in the branches has been reduced to only the writing of a batch proof sheet, perhaps with a trifling increase in the handling and the sorting.

The consolidation in the head office, of course, has been complicated a trifle because the consolidation at the end of the day in the head office is a consolidation of the work of all of the branches in that particular city. It also means that we operate only one clearing department and one transit department in the city; that our general ledger entries are all handled at the one point in the city; by general entries, I mean all entries except those that are applicable to the specific operation of a branch. For example, a branch will have its own general ledger showing deposit liabilities and income and expense accounts, but all other general ledger accounts will be carried in the principal office of the city or in the main office of the division in which the bank is located, and in some cases, as in the case of administration accounts, in only the head office at San Francisco.

There has been considerable economy, of course, in material. It has reduced the amount of equipment needed in the branch's mechanical equipment and has reduced considerably the amount of stationery, particularly the stationery which would be used for cash letters and letters transmitting clearings to the head office.

In Los Angeles we have extended that system until it includes all branches within a fifty-mile radius of Los Angeles, regardless of whether or not it is within the city limit, and, surprising as it may seem to you, there are some points fifty miles from Los Angeles where you can still be within the city limits.

This explanation probably has not been very complete, but if you are interested and want to ask any questions, I shall be glad to answer them.

MR. GREENUP: How often do you pick up those packages?

THE CHAIRMAN: Once an hour.

Of course you realize that while I have mentioned only the items going into the branches, this same messenger service makes deliveries of every character to the branches.

HENRY LACHENAUER (Fidelity Union Trust Company, Newark): When making up the batches, do you indorse the checks so that you identify the branches?

THE CHAIRMAN: Yes. The check is indorsed. It is not the ordinary clearing house indorsement, but every check as it goes over the teller's counter gets an identifying stamp which identifies it with that branch and with that particular teller.

In addition, I should explain what records we keep to identify lost items. Of course on items that come over the paying teller's counter, no

record is kept because in case of a lost item or the loss of an entire batch, the deposit tags and relative checks that came with the deposits are contained in the same batch; those can be traced on the original of the batch proof sheet.

In regard to the items paid by the paying tellers, the batch proof clerk has to make a record of the indorsers on his copy of the batch proof sheet, and those checks bear an identifying symbol that indicates that they have been checked and not deposited.

MR. UHLIK: I should like to add just a little to what you have said, if I may, as to one of the outstanding reasons also for this centralization of the items at one point. It gets to a specialization point. In other words, Mr. Smith's transit men and his clearing house men and adding machine operators and sorters, I dare say, can sort and handle three times as many items per man through the centralization plan as you could hope to accomplish in a day's work in a branch. So I think the centralization plan has been adopted by almost all the branch bankers in our country because it gives that speed and efficiency in handling the items.

THE CHAIRMAN: An illustration of the economy: We recently added one route in Los Angeles and that provided an economy in staff of eight persons among the branches included in that route.

We are handling in Los Angeles now 2,500 of these interbranch blotters daily in the central office, and between 200,000 and 250,000 items are daily coming in under this plan.

I should mention to you how the volume has become so large. We are handling in that office not only the items that originate in the Bank of

Italy but also those that originate in the Bank of America, which is another branch system closely affiliated with our organization, close enough so that we feel we can handle its items and have a working arrangement by which we can divide the expense and the economies.

MR. LACHENAUER: At the close of the day you have a certain hour that these items reach the main office, have you not?

THE CHAIRMAN: Yes. In Los Angeles it is six o'clock. The most outlying branch starts its items in at four-thirty and they are due in Los Angeles at six o'clock; the items are received at six o'clock and make the night mail out.

MR. LACHENAUER: Do you use air mail?

THE CHAIRMAN: Yes. It is ready for the morning air mail and is ready for the morning clearance.

Air Mail

By RUSSELL LeBROCK

MAIL TRAFFIC MANAGER OF THE BOEING SYSTEM, CHEYENNE, WYOMING

Address before the Denver Departmental Conference

Since the banker was one of the earliest supporters of air mail, one would suppose that with the remarkable advance made in the safety, the dependability, and the speed of the airplane, the banker would continue to furnish the bulk of its mail. But this is no longer the case. Bank mail now forms a relatively small portion of the air mail cargo, not because its quantity has diminished, but because social mail and non-financial business mail are taking to the air in greater and greater volume. Obedient to the rule of the majority, year by year it appears that air mail schedules will be arranged for the benefit of other groups rather than to meet the requirements of the financial houses, with a resulting decrease in the value of the service in the transmission of financial paper as time goes on.

If the banker can counteract this condition by arranging the clearing house closing time at various important cities to conform to the schedules of air mail arrivals, and if he can watch the time of mailing very carefully, so that his mail is posted to the best advantage, air mail will be of increasing value to him as it becomes increasingly efficient.

THE progress made by air mail service in this country is amazing. During the first year, starting May 15, 1918, we are told that some 700,000 letters were carried by air mail. In one month alone in 1930 our national air mail cargo amounted to approximately that many pounds. Every twenty-four hours mail planes fly 44,000 miles; 29,000 of these miles are flown at night, over airways developed and lighted by the Department of Commerce. In place of converted army aircraft used at first there are now specially developed cargo and passenger ships, machines of strength as well as beauty, fitted with all sorts of refinements for the proper handling of the cargo and for the accommodation of the air tourist.

The early patrons of air mail ser-

vice, who had faith in its ultimate success and by their support helped it to survive through its infancy, may justly feel proud of the part they have played.

THE BANKER AN EARLY ADVOCATE OF AIR MAIL

One of the foremost of these supporters was the banker. A few years ago, when the possibility of reducing the amount of time lost in transit by employing this comparatively new form of transportation was first considered, and surveys were made to determine just who might be most interested, and consequently most likely to give dependable support to the operation of air mail lines, the banker was found to be 'way up in front. Obviously, he would be. His busi-

ness dealing almost entirely with finance, it is natural that one of his axioms should be: "Money saved is money earned," which applies, of course, both to himself and to his customers; as money or its equivalent is always charged to some one and draws interest whenever it is out of its owner's hands, the banker could see in this faster service the opportunity to make a material saving in interest on securities in transit. He put up with some inconvenience at times in the early days when the young bird was trying its wings. Sometimes prolonged delays occurred, when it seemed that train mail would have been a better investment than air mail; there were times when fine young fellows, with hearts and nerves of steel, fought the demons of vicious nights and lost the battle, and the banker's portion was the burdensome task of trying to duplicate the items which he had sent in the shipment.

IMPROVEMENT IN FLYING

Little by little, the riders of the air were given improved steeds and better weapons with which to fight the elements; under impossible flying conditions, arrangements were made to move the mail forward promptly by train or other facilities, so that now it is rare indeed that train mail makes better time than air mail, or even as good time.

If you could stand by as reports on an approaching plane are received at a station and overhear the conversation as the pilot's probable arrival time is plotted, and then stay and watch him coast in and land within minutes, yes, often within a few seconds, of the time expected, I am sure you would feel that, basically, the air-

plane has progressed beyond the experimental phase, and that it has assumed its place in our scheme of things as a proved, dependable, permanent form of transportation.

If you were to know personally the men who fly the nation's air mail—many of them were flying the mail during its baptismal days, when the carrying of rabbit's feet was considered justified—and ask them about the flying of the mail, you would realize that the picture in their minds now is altogether different from that of a few years ago. The reasons? For one, equipment upon which the pilot knows he can rely. Just remember that although the planes which carry the mail operate in altitudes varying from sea level to 18,000 feet, and encounter temperatures which have been known definitely to vary from 35 degrees below zero to 135 degrees Fahrenheit, mechanical difficulties occur very seldom. Another reason for the pilot's increased confidence is a vast experience in his business, involving absolute familiarity with the terrain over which he flies and with the weather conditions which prevail there. He knows that if necessary he has a good emergency landing field, within gliding distance usually, but he knows, too, that the likelihood of needing it as a result of equipment failure is slight indeed. He can also talk by radiophone to folks in the air and on the ground within two hundred miles of him, and this makes him no longer alone with God when he goes out into a dark sky with the mail.

BANK MAIL NOW A SMALL PART OF AIR MAIL

It is paradoxical that the bank

mail, which provided one of the strongest pillars for the support of the air mail service immediately following its inception, now forms a relatively small portion of the air mail cargo, not because its quantity has diminished, but because social mail and other types of business mail, which did not put in a frequent appearance during the pioneering period, are coming into the air mail in greater and greater volume. Obedient to the rule of the majority, year by year it appears that air mail schedules will be arranged for the benefit of social mail and other types of business mail, more than to meet the requirements of the financial houses, with the result that I can imagine a decrease in the value of the service in the transmission of financial paper as time goes on. If, for example, certain changes in schedule appear necessary to favor the receipt of mail on a late closing at some large post office or in order to make possible the receipt of an important connection, it may cause too late an arrival at an important banking center to permit mail to reach the clearing house in time to receive credit on the day of arrival. It is understood that this condition is more serious in the case of checks than in that of bonds, as usually the dead line on checks is reached much earlier than that applicable to bonds. In New York, for instance, we are advised that checks must reach the clearing house by 9:00 a. m., whereas bonds have until noon to clear. Arrival beyond the clearing house time limit nullifies the value of the high speed service on bank items, whereas ordinary business or social correspondence will still serve a purpose if delivered by afternoon carriers.

The bankers might, perhaps, over-

come this obstacle by arranging the clearing house closing time in various important cities to conform to the schedules of air mail arrivals, and, in case of a change of schedule being made, varying the clearing house time accordingly. I am not sufficiently familiar with the conditions surrounding the handling of clearing house mail to know whether it would or would not be feasible to try to make these changes. That they would be instrumental in providing a greatly improved service to the banker appears to be a certainty, and it pleases me to be able to suggest this thought to you, with the idea that at a congregation of so many representatives of the banking interests of the country it may be possible to give the question such consideration as it warrants and to take definite action if a way can be found to do so.

WATCHING THE TIME OF MAILING

There is another way in which all mailers may themselves assist in realizing the full benefit which can be gained by using air mail, and that is by watching the time of mailing. Much is lost by failure to arrange special mailings at times when direct connection can be made with planes; a few minutes too late and the plane is missed, necessitating the mail's dropping back to connect with the next plane, with the result that the delivery intended is lost. There are many cities in the country through which planes pass during odd times of the day when the regular business closing will not provide a connection.

No doubt many of you, perhaps all of you, are seeing to it that your mail is posted to the best advantage.

Any of you who are not will find yourselves well rewarded if you will make use of details, which the postmaster will be glad to furnish, about when and how to mail.

If you can arrange to have mail placed in the post office at the time necessary to permit connection with the ship which will give it the best delivery, and to set the clearing hours so as to give the greatest leeway possible in crediting items brought in by airplane, the slack thus taken up at both the mailing and the delivery end would result in decidedly improved service to you, and your clients, and would contribute proportionately to the success which we all hope to attain.

Discussion

EDGAR L. UHLIK (Security First National Bank, Los Angeles): I realize, Mr. LeBrock, that fire is one of the greatest things you people have to contend with. Fire is also one of the greatest things that bankers have to contend with when they use air mail. Are there any preparations, or is there any method anticipated which will reduce that danger in the air mail service? It is easier, you know, to get a duplicate if you have a part of the check than it is if you have nothing at all.

MR. LEBROCK: You folks have put up with some tough propositions in the past. I should like to answer that by asking another question. Have you noticed that you have had fewer losses the last few years than you did previously?

MR. UHLIK: Frankly speaking, no. During the last six months, unfortunately, there has been a series of serious accidents. There was the one

just recently, and then the Clearwater, Pennsylvania, plane that went down and partially burned, and then the last one at Bedford, Ohio. Those are the only three in the last six months; those three are really the only three that did any serious damage to us, but they were bad ones.

MR. LEBROCK: There is really nothing that can be done positively to safeguard against fire, any more than you can safeguard against fire in any sort of equipment. There is, however, improved equipment being put out from time to time with extra precautions taken. Each accident which occurs, of course, teaches its lesson and is thoroughly investigated to see if we cannot forestall what happened at that time. I think the policy followed by our company is followed by all. Some may have better records than we have, and others may not. We feel that our record has been very good considering the mileage. But, as I say, experience of that kind is used as a means of preventing a similar accident in the future. Most of your accidents, I believe, where you have had losses, have been in violent weather conditions.

Cleanliness is one of the greatest things in air mail service, of course—cleanliness about the ships—for the accumulation of oil and grease and things of that sort make that much more opportunity for fire.

My thought in asking whether you had noticed an improvement in your losses was because I believe there have been fewer accidents in the last few years than there were before. There are many contributing causes for that. In the early days the boys had to climb into a ship which, in the first place, was a converted army ship and was not suited for the particular kind

of work they were using it for. If it was too bad they came back, unless they got caught before they got back. Now they have very complete weather forecasts available at all times. We have our own weather forecaster employed by the company, who cooperates with the government officials and gives us his final opinion as to what to do. In that way the pilot knows when he goes out just about what he is going to run into. Added to that we have the radio which enables the pilot to talk to the ground and to other ships at all times, and in that way, if he is going into questionable weather, he can get the reports from other ships which have been through it, or from the ground stations located in a ground area, and he will know whether he should attempt it or not. Our policy of course is not to try to buck it if it is impossible. We get the mail by truck or train past the bad spot and then go ahead with it. It may delay the mail a little, but you would rather have it delayed than not have it at all.

FRED J. ROBERTSON (Peoples Wayne County Bank, Detroit): In regard to fire losses, we have had very few in our work, but the two that I can remember most vividly happened to be bill of lading shipments covering shipments of motor cars that were sent out long distances and that had been returned, and we wanted to get the bill of lading to the right party inasmuch as the carriers had already arrived. We used air mail in both instances and had loss by fire; it tied things up for a considerable length of time.

Is this mail carried in a compartment in the plane?

MR. LEBROCK: Yes, just a loading compartment.

MR. ROBERTSON: Has there ever been any thought given to having a trap there and letting the whole thing drop by parachute?

MR. LEBROCK: It has been thought of, of course. It would involve an entire redesign of the ship.

MR. ROBERTSON: What about the mail bags—are they fireproof?

MR. LEBROCK: Not only are they not fireproof, but I doubt very much if they can be made fireproof. I had an interesting experience when I was with the railway mail service. There were several tests conducted through the courtesy of a prominent fireproofing organization, where mail bags made of asbestos and various combinations were tested out, and while it was possible to produce mail bags which would not burn and which would protect the contents a certain length of time, in one case that I recall, which was the last time that I observed it, the bag was allowed to cool for one-half hour, after which we opened the neck of the bag and then it began to smoke. So I doubt whether it would be possible in a fire such as we have in an airplane under present conditions to build anything which would be fireproof.

MR. ROBERTSON: We have quite a bit of use for air mail and it is usually on something special like that that something happens.

MR. LEBROCK: It may be that you have something very special on that one plane and that some one else may have something that is not so important in that particular case. But most of the mail which is carried by airplane is very important mail.

MR. ROBERTSON: The effectiveness of the service was brought to my mind especially just this morning. I went to see if I had any mail about

eleven o'clock and found a letter from Detroit mailed in the post office at two o'clock yesterday afternoon.

MR. LEBROCK: That is getting the map down quite a good deal. The service is there, and I believe a careful analysis of the losses compared to the number of trips made and the amount of mail handled will show that the percentage of loss is very, very small. I saw figures on it several years ago—about a year ago, I guess—and as I recall it the figure was .007.

MR. UHLIK: We have all read of this new motor development—the Packard Diesel. Is that as much subject to fire as the gasoline motor is?

MR. LEBROCK: No. The Diesel type of motor is not as subject to fire as the ordinary type of gasoline motor for the reason that the principle is altogether different. In the first place, crude oil is burned, or very heavy oil which is not readily combustible. And the method of firing is by making the compression so strong that the stuff explodes naturally. In other words, no sparking device is necessary.

MR. UHLIK: Do you think mail planes will ever use that?

MR. LEBROCK: I do not know. From what I have heard of the motor, it is not sufficiently developed yet to be put into commercial production.

There is another item in connection with that. I just recently saw that the Pratt & Whitney people had conducted experiments with a new type of carburetor with which they could switch from one sort of fuel to another; burn gasoline, or crude oil, or another fuel, merely by running it through this carburetor. If that is true, it could be used on the present motor simply by substituting that carburetor.

MR. ROBERTSON: In connection with that fire hazard in the Diesel engine, I might relate an interesting incident. I happen to be personally acquainted with Captain L. N. Wilson who had a large part in developing that motor, and I had the pleasure of riding the plane equipped with one of those. You perhaps are all familiar with the fact that Captain Wilson met with an accident while delivering one of these planes to a New York manufacturer. He was not piloting the ship, however, and I feel confident that if he had been, the accident would not have happened. But the accident happened in passing a mountain in Pennsylvania in a snowstorm, and while all the men were killed, the plane did not catch fire.

I also know several of the officials who are connected with the development. When they do get the motor developed to such a stage that they will be able to offer it in different power ranges, then I think it will be profitable and will no doubt be adopted for air mail. But at the present time it has only 225 horse power and it may not be sufficient for heavy loads.

CHARLES HEMMINGSEN (First Seattle Dexter Horton National Bank, Seattle): Are the packages of mail tied up on both sides?

MR. LEBROCK: Your short letters are tied up in packages two inches thick. The twine is put both ways around and tied at the corner or at the intersection of the string. The reason that you have the centers is that the edges burn all the way around but the center is packed in quite tight and holds its form. If there isn't a complete fire the center part is the part that is saved, and, incidentally, that is where your address is.

Research As an Aid to Profits

By H. MILLER LAWDER

ASSISTANT SECRETARY OF THE IRVING TRUST COMPANY, NEW YORK,
NEW YORK

Address before the Denver Departmental Conference

Mr. Lawder divides his address into three main parts: the purposes, benefits, and dangers of research; the kind of research organization to be set up; and specific examples of research work as it has been carried on by the Irving Trust Company.

In the discussion of research as a whole, he defines the purposes of research as being

1. Simplification of operations
2. Introduction of economical methods
3. Development and training of personnel
4. Coordination of organization
5. Minimizing of costs.

In the Irving Trust Company the research unit has brought about various improvements. Mr. Lawder mentions specifically changes in bookkeeping equipment, the establishment of a training school for new employees, four definite ways by which the handling of items in the incoming clearings department was speeded up, changes in forms and machines used.

Mr. Lawder feels that research of the right kind not only does not cost anything, but, on the contrary, if directed along proper channels and backed by high authority, pays dividends of significant size.

RESEARCH is a formidable word. It brings to most people's minds the idea of a mysterious function performed by queer people behind closed laboratory doors, and involving the use of extremely complicated methods. Some years ago, perhaps, when research as such was performed only in the field of chemistry, physics, and allied sciences, there undoubtedly was some justification for this viewpoint. More recently, however, there has been increasing recognition given by the business world to research and the scientific viewpoint. This trend is significant. Its importance to the banking world is worth our careful consideration.

I propose today to discuss with you briefly, first, just what research

is, what are its purposes, its benefits, and its dangers. Second, we shall consider what kind of organization might be set up to help research to function, that is, what are the mechanics of the operation of research in a business organization. Third, I shall give some specific examples of research work as it has been carried on by the Irving Trust Company in an effort to provide its management with an effective aid toward increasing net profits.

RESEARCH IS SIMPLE

Now at the start let me tell you that research can be a very simple thing. There need be nothing very expensive or formidable about it,

whether carried on in industry or in banking. Huge laboratories employing many scientists, or large departments filled with efficiency experts, are not necessarily essential. In its simplest form, research need consist of nothing more serious than a disposition on the part of a business to look its affairs over, determine the facts, evolve a remedy, and apply it in a practical way.

Research in this sense is a process that may move along with everyday business and be hardly noticeable. We might say that it is just a point of view, a habit of mind, which can give a scientific color to the daily study of business problems.

APPLIED VERSUS PURE RESEARCH

In general, there are two kinds of research: pure research and applied research. Pure research has no definite objective in mind, but is carried on with the expectation that beneficial results not determinable at the beginning of the study may develop. A Rockefeller or a Carnegie may endow a laboratory for pure research, with the hope that some facts of value to the human race may be developed. This type of research is rare. We are more familiar with applied research, which is that kind of research having a definite objective, such as improving a certain operation or developing a new product. That is the type of research with which we are concerned here today, research having the definite objective of decreasing the costs of bank operations and increasing net profits.

Many large industrial units, such as General Electric, American Telephone and Telegraph, General Motors, have given research a high place

in their business organizations. The principle they follow is readily adaptable to small business units. The conditions of the particular case determine whether the effort costs much or little. The important thing is whether the trend is sound and in the right direction. Research can be as well exemplified in the case of the bank officer who is his own planning department and operating head and business getter, as in the case of the giant laboratories in Schenectady, Wilmington, and Pittsburgh.

THE PURPOSES OF RESEARCH

The underlying purpose of research is to give the management of an organization a fact-finding unit which will enable it to reach sound conclusions in the direction of the company's policy. It is the kind of study and investigation which will enable a well managed business unit to

1. Simplify its operations
2. Introduce economical methods
3. Develop and train its personnel
4. Coordinate its organization
5. Minimize costs.

These elements are familiar to all of you; you meet them every day in your capacities as officers and department heads. But I wonder if we should not for a minute go behind these purposes and make clear in our minds what we know to be the guiding principles which enter into the establishment of research work.

GUIDING PRINCIPLES

1. Research activities must be given a standing commensurate with their value to the corporation; this means giving research

- the backing of the highest authority.
2. The persons assigned to conducting research studies must not be under operating stress, but should be detached from such responsibilities in order to be able to devote their entire time to analytical and impersonal study of facts.
 3. Research activities must not lose touch with current operating conditions; theory must be seasoned with practical workability and must retain the viewpoint of the worker on the job and of the office or department head responsible for production.
 4. Research must be intelligently directed into the channels where results are greatest.

BENEFITS OF RESEARCH

One factor stands out above the rest. I refer to the absolute necessity for a clear-cut separation of responsibility for operations from responsibility for research. The two do not mix. If performed by the same persons, one is bound to suffer in favor of the other. The very nature of research makes it essential that those carrying on that kind of work be free to study and to analyze and to test, uninterrupted by routine assignments.

The advantages of this arrangement are obvious. In the first place, the organization which has created a research unit, has thereby provided one place in the company where suggestions for improved methods, forms, and machines are sure to receive the attention they deserve. It is as though they put a sign over the door read-

ing "Clearing House for Ideas." No more shelving of suggestions by executives too busy to read them. The good old alibi, "We have always done it this way," becomes out of date. It is replaced by "What are the facts?"

I do not mean that suggestion boxes and cash prize plans to encourage the clerical staff to contribute ideas on practical improvements and methods are obsolete. These can be very effective and will continue to fill a certain place in the management scheme. But at best their yield is spasmodic, and any sustained enthusiasm for them on the part of the staff has to be jacked up periodically or else the boxes collect nothing but dust. Research, on the other hand, is uninterrupted, continuous, on the job all the time.

In the second place, a separate research unit can be more ably supervised and directed than a unit tied in with operating responsibility. A birdseye view of the organization's operating, mechanical, and personnel problems is obtained, and effort can be concentrated on the studies which will yield the highest return.

DANGERS IN RESEARCH

There are three dangers in research continually to be guarded against. One is the tendency to become too theoretical. The research activity must never lose sight of the viewpoint and problem of the worker on the job and of the conditions under which he works.

The second danger is that research may move too slowly. Its findings may be out of date, and the problems it was studying may have changed by the time its recommendations are

made. One of our officers told me a story which illustrates this. He said, "My wife had never had much experience in practical housework when we married, and when our first son was born she decided to knit him a sweater. She got the yarn and knitting needles and set to work. Halfway through the job one of her friends told her that she was doing it all wrong, so the sweater was unraveled and begun again. This happened two or three times during the learning process. Many months later when the sweater was finished according to its original specifications, the baby had so far outgrown it that it was useless."

This can happen to research if it gets too involved and loses sight of its objective. By the time it has developed a solution, conditions have changed so much that its conclusions are of no value. An effective way to prevent this is to set a time limit and plan to clean up the job by a definite date.

The third danger of research is the tendency to gather too much data and too many facts instead of stripping the problem of its unessential details. The foundation of the research idea is to direct attention to essentials and to eliminate non-essentials, non-essential machines, non-essential forms, non-essential methods, non-essential people.

I have gone to some length to review with you the underlying principles governing a research activity. Let us now see how research actually works in practice. What are the mechanics of its operation, and what are some concrete examples of how it may serve to increase net profits?

In 1923 the management of the bank with which I am associated

made what was considered at that time a somewhat radical change in its organization structure. Each department and division and section was classified according to its function. This had the effect of fixing responsibilities where they belonged and defining for each member of the official and clerical staff his or her place in the organization. This functionalization of activities was carried through the entire company in each of the banking offices, whether they employed a dozen or several hundred.

At the same time a so-called general office was created. In this office were located the activities which could best be carried on in one place for the company as a whole: the handling of clearing house items, a central collection unit, loans of surplus funds, and other operations necessary to the completion of the day's work of the trust company.

THE RESEARCH UNIT

In addition, however, recognition was taken of the new and important changes in bank functions and organization which were then appearing on the horizon; the significance of the merger movement then getting under way, the ever increasing scope of banking services, and the close control over operating expenses made necessary by the demands of competition. In order to meet such problems, a few officers and members of the staff were transferred to the general office from their operating positions to give a major part of their time to research. One of the main requisites of research work was thus fulfilled: the disassociation of those engaged in such work from day by day participation in detailed operating jobs.

The mechanics of operation of a research unit of a bank can be very simple. Here is an example of how it may work. Let us suppose that a department head has an idea that by adopting a new machine and changing a form or two, he can simplify his records, cut out some unnecessary handling of items, and reduce the work of his department by several hours. He puts the suggestion on paper and forwards it to the research unit, confident that it will receive immediate attention and thorough investigation.

The research unit checks the facts and tabulates any additional ones pertinent to the problem. It investigates how other companies handle similar operations in order that their latest ideas may be compared. It reviews the mechanical appliance market relating to the particular problem, as well as subsidiary equipment and forms involved in the process. With all the data at hand, the research unit is in a position to make its recommendations. When they are tested in practice and found of value, each department handling similar work in the company is fully instructed how to adopt the new method.

RECORDS OF PROCEDURE

It is important that such instructions be put in writing and issued to every individual concerned. The research unit is responsible for doing so. It prepares a clear-cut exposition of the methods studied and found practical. This is arranged according to departments or divisions and may be called Manual of Procedure or whatever other name may be found desirable. These are kept up to date so that operating heads have at their

command at all times a reference book which states in clear and concise form the best known practice in the company for handling all its operations.

The research unit has thus acted in this instance as a clearing house for information, keeping all interested persons advised concerning the recent developments designed to eliminate waste, improve methods, standardize procedures, and train the staff.

MACHINE BOOKKEEPING

So far I have confined my description of research to general terms. I would now like to give you a few examples of actual research work as it has been carried on in the Irving Trust Company.

One outstanding illustration is in the study of bookkeeping machines for depositors' accounts. In 1924 the Irving knew it would have to spend during the next five years over a quarter of a million dollars for bookkeeping machines to replace hand methods and depleted machines then in use. It was not going to do so until it was satisfied that every dollar of its investment would give maximum return. The outstanding types of machines on the market were brought into the research department and operated for weeks under working conditions duplicating as nearly as possible those in a bookkeeping department. The cost and annual service charges and repair charges of each machine were tabulated and the probable life of each machine and its depreciation recorded. The speed and number of items handled by each machine were determined by time studies. The salaries required for each type of machine operator and the training

period necessary to make the operator a competent one were taken into consideration. Incidentally, during the course of the study, eleven minor mechanical changes in one of the machines were recommended to the maker and accepted by its factories. Both the bank and the machine company benefited. The dominant motive at all times, however, was to get the facts and to analyze and present them in such a way that the management could make its decision.

The study of bookkeeping equipment did not stop there. After the machine had been selected, it was necessary to give the operator proper supplementary tools with which to work. Therefore the best features of every available desk were studied and consolidated into a new type of bookkeeping desk made according to our specifications. The desk now on sale by one of the leading equipment concerns in the country had its origin in a wooden model built during the course of this research. Chairs were studied, ledger trays and binders analyzed. The proper weight and size of carbon paper and ledger and statement sheets were determined.

TRAINING SCHOOL

Finally, a training school under one of our own teachers was established to teach new employees the best method we could develop for performing their machine operations. This school is set up like a small bookkeeping department with machines and ledgers and statements and checks going through just as they do under regular operating conditions. The time required to train a new employee (three weeks) represents a substantial reduction from the time for-

merly required. This is in part due to the fact that at the school the pupils receive eight hours' instruction a day, as compared with one or two hours at best if we attempt to teach them on the job in active departments. Moreover, the training is complete, is uniform, and is up to date, instead of varying according to the knowledge of different department heads.

VOLUME AND COST

In our own case, approximately 300 people are engaged in bookkeeping work, and the total number of items handled each month runs as high as 2,545,000. By constant study of this important activity, the cost of handling an item in the bookkeeping departments in 1929 was 30% lower than in 1925.

The research unit, having established standard machines and equipment and uniform methods, now reviews monthly a classified report of items handled by each bookkeeping department of the company. These volume figures are carefully analyzed to determine whether each department is maintaining satisfactory production standards. Specific recommendations are made to correct high cost per-item conditions whenever they appear.

SINGLE POSTING

The final step in this process of machine bookkeeping research, so far as we are now able to predict, is the possibility of posting ledger and statement in one operation with one machine and one operator. This is now under active study and test. The Irving is not by any means the pioneer in the investigation of this new-

est bookkeeping development, for many other banks are making similar tests in an effort to determine what economies are possible in this direction, and some have already put a single posting plan into operation.

The entire problem of machine bookkeeping is one with which all of you are more or less familiar. In almost every bank it represents an important proportion of the staff; it handles the largest number of items; it represents the largest single investment of the bank's money in machines and equipment; it calls for a high type of supervision and careful training. Therefore it merits the time and expense necessary to develop the best possible methods by means of research, for the savings are proportionately higher than for similar effort expended on smaller units.

INCOMING CLEARINGS

Another bank activity that offers a fertile field for research is the incoming clearing department. Here we deal in the aggregate with large figures, volume and dollar amount. This is true in proportion to the size of the bank. The Irving received during the year 1929 an average of 75,000 checks in the incoming clearings department every business day, with a peak of 143,000 on a single day. The dollar amount involved for the entire year was approximately \$28,500,000.

You will agree that possibilities of delay in handling this large volume are numerous. One unnecessary handling of 75,000 checks is felt all along the line: bookkeeping departments are delayed; reports of drawings against insufficient or uncollected funds are delayed; important officers

of the company are handicapped by receiving late information regarding balances of accounts.

Four important instances may be cited which may give you some idea of where to look for an opportunity to speed up the handling of items in this department.

ELIMINATION OF TWO MACHINE LISTINGS

1. The problem consisted of distributing 75,000 checks daily to offices throughout New York City, some of which are 45 minutes from the incoming clearings department, and doing so with proper control, with as few missteps as possible, and with speed the predominant factor. Well, we could not speed up New York's subways or elevated trains, so our only controllable point in the flow of items lay in the incoming clearings department itself, where one extra handling of 75,000 checks or one unnecessary listing would involve in the aggregate many hours' additional work. After a great deal of careful research the entire procedure of handling was revised, with a result that two machine listings were eliminated between the time checks are first received from the clearing house and the time they are posted.

a. The first listing eliminated was that formerly made at the time the packages of checks from each bank were first received. Now the checks are sorted immediately according to our banking offices and not until then are they listed. An identification block number makes possible a reconciliation of the figures later in the day when time is not such an important element.

b. The second listing eliminated was that made at each banking office

at the time their particular packages of checks were received from the incoming clearings department. Now the checks are immediately sorted according to ledgers, and then are listed, thus establishing figures necessary for control and reconciliation.

The entire procedure of handling, from the time the items reach us from the clearing house to the time they are posted on depositors' accounts has been simplified, so that it functions automatically without any loss of control. Should any of you here present be interested in seeing a brief description of the operation and samples of the forms used, I should be only too glad to send them to you. If, after you have compared it with your own, you find that you have developed some short cuts that we do not know about, please telegraph us about them, collect!

WEIGHING INCOMING CHECKS

2. When the armored car bringing checks from the clearing house arrives at the incoming clearings department, it is very important to know what the volume of the clearings is, in order that a reserve force may be put on the job to handle sudden increases over normal. There is not time to count the items, so we weigh them. Did you know that you can weigh packages of checks and find out with remarkable accuracy just how many there are in each package? There are 260 checks to a pound if listings and envelopes are included; 270 if removed from envelopes. This weighing process takes but a few seconds, and enables the supervisors to make a quick check and see if adequate sorters and listers are on hand, and to apportion the work fairly and

rapidly. The slow and laborious task of counting the checks from the listings is eliminated.

PART-TIME WORKERS

3. Formerly each banking office of the Irving sent anywhere from one to eight representatives, depending on their proportionate share of the volume, to the incoming clearings department each morning between the hours of 9:00 and 11:00. These people were drafted from bookkeeping, rack, or messenger departments. We were quite certain that this movement of approximately 60 to 70 clerks to and from the central office daily was wasteful, and that they were being retained in some cases on the rolls of the respective banking offices for this morning work rather than for actual needs in the afternoon for messenger or rack work.

Accordingly we began experimenting with part-time workers, often young married women with banking background who did not want full-time positions but were willing to work three hours each morning at a salary of about \$15 to \$18 a week. Twenty-four part-time workers replaced a like number of full-time workers; this represented a 50% reduction in personnel and salary costs. As a further result we had the advantage of a permanent group trained in the handling of incoming clearings.

Incidentally our previous experience in the coupon collection department had proved to us that the use of part-time workers was practical. In the coupon department we have on call a selected list of women who are called in to work during peak periods, sometimes for the first month of each

quarter, and in other cases for one or two weeks of each quarter. Of the twenty-five part-time workers in this group, there has been a turnover of only two people during the past two years.

There are a large number of young women, and young men too, anxious to secure part-time jobs. The market for such workers, particularly in the morning hours, appears more than adequate. This is not a temporary condition arising from the employment situation. These workers are in many cases students working their way through local colleges, or are young married women anxious to help the budget by working during the mornings. The principle of supplying a separate group of part-time employees to meet the volume peaks of the day, rather than recruiting from other departments, is in our opinion a sound one and should be applicable to other activities of the trust company.

A 2:00 A.M. CLEARING

4. Lastly, and this goes back a few years, the clearing hours for the New York Clearing House were formerly 9:00 a.m. to 10:00 a.m. This meant that from the time the banks closed the previous night until 9:00 a.m. the following morning, thousands of checks all ready to be cleared were lying idle in their vaults. As a result, the following morning huge numbers of clerks in every bank had to be marshaled to handle clearings in time to have the items received and posted by the bookkeeping departments and returns made. Considerable research work on the part of the largest banks in New York City showed that over 60% of the volume of the day's clearings were

ready to be cleared the previous night. Accordingly a 2:00 a.m. clearing was arranged for and has been operating successfully since its establishment in 1926. This was merely another step along the same lines, the fundamental purpose being to eliminate delay and speed the movement of the items to their ultimate destination.

RESEARCH ON FORMS

Much has been said and written about the control and use of printed forms in the modern business office. I wonder if we realize this significant fact: that in a bank practically every single job is carried on entirely by means of forms. Forms of large size, small size, blue, white, yellow, ruled and unruled, duplicates and triplicates, checks and statements and tickets—forms that can be little more than a mob of papers, or can be a well organized, effective army under control.

The Hammermill Paper Company in an interesting series of booklets published last year, has coined a phrase "silent organization," by which they mean the system of forms, records, reports, and memoranda by which the operations of a business are initiated, controlled, and recorded.

Have you reviewed your silent organization lately? Have you taken a look at every form originating in your department or division and asked yourself these questions: Is this form adequate for the purpose intended? Can it be simplified? Can it be combined with another to serve a dual purpose? Are its printing, ruling, color, and size the most economical possible? Can it be eliminated altogether?

Do you know the total number of forms in use in your organization? Do you know, for example, whether low-priced paper is used for temporary forms and whether the proper quality paper is used for forms kept as bank records for 10, 15, or 20 years or permanently?

STEPS IN RESEARCH ON FORMS

The study of forms should be made one of the permanent functions of a research unit. Under proper direction it will save the salaries of those engaged in the study of forms many times over. The steps in the process are simple:

1. Take all the printed forms in use in the entire company and mount them on exhibition board, classified as to departments.
2. Arrange to have every interested executive review the exhibit. The initial elimination of useless and duplicate forms will be substantial.
3. Arrange to have every requisition for a form, no matter where it originates, clear through the person conducting the study for review before printing.
4. Have him compare with similar forms every one that comes to his attention; simplify their set-up, discard those seldom used, and review the quantities and printing costs.
5. The proper operating department should be consulted and approval secured for any changes or eliminations in forms affecting that activity.

In 1923 the Irving had approximately 4,500 printed forms in use.

Today there are less than 1,400. It requires very little imagination to estimate what the dollar savings in printing have been, to say nothing of the reduction in stock records in the purchasing department and the saving of space in stationery storerooms.

In a bank having many branches an important item of printing cost is having each branch's address printed on its forms. This sounds like a small matter, but it actually doubles or triples printing cost. A careful review of all forms on which the bank's address appears may show that a great number either do not require the address or else that it may be typed or stamped in without hurting the appearance of forms.

RESEARCH ON MACHINES

Very similar to forms research is the study of machines. It is practically impossible for an operating bank officer to keep up to date on the newest developments in the office appliance and office machine field. There may be many hundreds or thousands of dollars' worth of information in the salesman's briefcase but the busy executive simply cannot give the time to investigate the facts.

A research unit, however, can investigate and compare, make cost studies and time tests, find out what the production is and whether the machine is worth while. It can review the uses of each new machine and mechanical appliance with a company-wide application in mind. It is not limited to a restricted departmental viewpoint.

All requisitions for new machines should clear through a central point in the research unit. This insures proper control and the purchase of the

best machine for the job, and also means that the research unit as a clearing point will know whether any machines are available in other places in the company to do this work.

Similar to a form study, it is essential that there be prepared an inventory of every machine in the company, showing the date of purchase, cost, depreciation, repairs and maintenance charges, number of hours per day in use, and type of work handled. These facts provide the foundation for the continuous study to keep machine costs at a minimum, and to utilize as much of the company's machine equipment as many hours of the day as possible.

The examples of research I have given you have been limited to problems arising in the deposit functions of a bank. Just as valuable opportunities for research are provided in the operations of the credit, trust, and foreign divisions. Studies relating to forms and machines, and so forth, are of course carried on from a company viewpoint regardless of divisional lines.

SUMMARY

In summary, may I remind you that we as bankers have learned many a lesson from industry in the past. We can agree, I am sure, that a substantial part of our present methods of analyzing the cost of items and accounts, our production planning, our emphasis on service, our advertising methods, has been patterned after industry, and now we are on the threshold of another lesson, which is ours for the asking: research and its value as a means toward increasing profits. The industrial organizations that come through the present period

of lower earnings without great difficulty will be those with the foresight to have depended upon a sound basis of fact-finding research.

You have seen that there is nothing mysterious or complicated or impractical about it. I am certain that a great majority if not all of the banking institutions represented here today have carried on research in the sense that I have described it, and will continue to do so. You may not call it by the same name, but that is not material.

Your presence here at the Institute Convention is evidence of the fact that you are willing to spend time and money in discussing such problems with your fellow bankers. You are seeking better methods, sound policies, new ideas, to take back to your own institutions.

For the past three days we have listened to many interesting talks on matters that concern all of us in our daily work. Some of the topics discussed have left questions in our minds as to the best solution applicable to our own institutions.

I believe that if the banks represented here pledge themselves to adopt the "open door" policy with respect to their own research studies and operating improvements, we shall be taking a long step forward toward reaching a practical solution of our common problems. It is hoped that, during the coming months, machinery can be set up to accomplish this purpose. Each succeeding A. I. B. Convention should bring us a report of work accomplished during the winter by regional and group studies. The cooperation of all of us will make this possible.

In conclusion may I quote from a recent address of John J. Driscoll,

who has addressed groups of bankers throughout the country on the subject of bank management. He states:

"Bank management to be most effective and profitable must base its policies, conclusions, and plans on facts. Careful analysis only will establish these facts. Unprofitable bank management lacks knowledge and therefore lacks a basis for determining definite policies. Such banks usually follow programs dictated by competitors, who in many instances may be weaker and less efficiently managed than themselves."

His words express in a slightly different way the principles of research I have attempted to develop before you this afternoon. Research is a difficult step, but once taken it gathers momentum as it produces results. Research of the right kind does not cost anything. On the contrary, if directed along proper channels and backed by high authority, it pays dividends of significant size.

Discussion

HECTOR SEATON (First National Bank & Trust Company, Flint, Michigan): Mr. Lawder, I should like to know how you get a proof of the double posting statements checked up against your ledger. I should like to know how that proof is taken.

MR. LAWDER: As I stated in my talk, we have not yet developed a final operating plan for single posting. The experiment so far, however, provides for the ledger operator and the statement operator to be replaced by one operator and by part-time work of a control clerk. This control clerk is responsible for taking a pre-run of the balances to be affected by a given batch of items. He takes the checks received from the clearing,

or deposits received from the teller, goes through the ledger sheets, and takes a total of the balances of the accounts affected by tickets. That total is proved by the machine operator when she posts the items, through the use of the accumulator placed in the machine. A second step is to have the control operator review the checks in the files before the statements are mailed to the depositors to make certain that the entries have been made on the correct statements so far as posting is concerned.

GEORGE L. GREENUP (National Bank of Commerce, Detroit): When you set up a standard procedure for a department, do you supply the department with a manual showing just what the duties are?

MR. LAWDER: Yes. In the hands of each division and department head is placed a copy of Manual of Procedure or Standard Practice; it does not make much difference what it is called, but it is a clear, detailed write-up of the operating method to be followed. It is, as I said before, a reference book to be consulted to find out how any given operation is to be performed.

EDGAR L. UHLIK (Security First National Bank, Los Angeles): Recently I saw a very short moving picture of an adding machine operator who apparently has started to revolutionize the operation of the adding machine. You may have seen it. In the hope that it may be helpful to all who are interested in volume production, a brief explanation of it may be of advantage.

This operator has synchronized the pressure bar on the adding machine with the actual pressure of his fingers on the keys. They are both done at the same time. He also includes his

thumb for the pressing of the keys. We got quite a bit of enthusiastic response from all of my men who saw the picture. Whereas the normal speed of an average operator is 150 checks in about three minutes or 180 seconds, it has been reduced in many cases, inside of a month's practice, to 150 checks in 128 seconds.

We are all looking forward to volume production and this little system that this clearing house clerk or batch head started, I am sure is going to assist us considerably in handling the volume of business that we have.

He operates the machine in a very peculiar way; and it seems that he does it entirely without effort. He will stand and talk to you at the same time that he is working the machine. He keeps pushing that hand down just as hard as he can, and his left hand is turning checks over as fast as it can go. His production is remarkable.

THE CHAIRMAN: In other words, we enter the era of the educated thumb.

MR. LAWDER: May I ask where that film was made?

MR. UHLIK: It was made at the adding machine elimination contest, at San Francisco, I believe, about three months ago. This man ran 150 checks in seventy-eight seconds, and he was talking at the same time to a representative of the Burroughs Adding Machine Company who made the film.

THE CHAIRMAN: With a little more practice he will be able to wash the windows while he is doing it.

It occurred to me to mention at this conference what I heard some one say was the greatest nuisance we have in transit work, and that is the stamp-

ing of checks not to be protested. We all recognize the nuisance that we have in the checks that are so often protested because the "no protest" stamp has been omitted and because the covering instructions on the cash letter called for the protest of all items over a certain minimum amount, and it occurred to me to repeat the question as I have heard it asked, as to why we make our instructions to protest all items not marked "no protest." Why not protest all items marked "protest" instead of having thousands marked "no protest"? Why not stamp only those that we actually want protest on and eliminate all that trouble? You in the East are worse off than we in the West when you get back an item, particularly a California item, with about a five-dollar or six-dollar protest fee added when it is perhaps only an eleven-dollar check.

I do not know whether any consideration has ever been given to the question or not, but I wonder what some of you transit men would think about reversing it.

ALDEN FIELDS (Foreman State Trust & Savings Bank, Chicago): We do that in the collection department. Our collection letters are all marked "no protest."

THE CHAIRMAN: Of course, if you handle a relatively small number of items in the collection as compared with the transit department, your labor of stamping in the department is proportionately greater.

It seems to me that this is a thing which might properly be brought before the Operating Committee of the American Bankers Association.

DON CROULEY (Northwestern National Bank, Minneapolis): Isn't it true that the instructions are perhaps

general, and isn't it true that a few banks in the East do not stamp their items "no protest" unless their customer wants no protest, and that if they want them done in that way they stamp them?

HENRY LACHENAUER (Fidelity Union Trust Company, Newark): In our case the stamping of the item "protest" would involve more work than under the present system. At present, if a depositor does not wish the check protested, it rests with him to protest. We supply the stamp to him "no protest" and then the number of our bank. That seems to be acceptable among all the banks.

THE CHAIRMAN: That is a point which some of you might take home

and look up, to see what your present practice is.

RONALD T. SYMMS (Federal Reserve Bank, Spokane): There is one objection in connection with stamping an item "protest" rather than "no protest." As I see it, the protest is for the protection of the indorser, and if an operator or clerk detailed to stamp an item "no protest" should fail to stamp it in error, the bank would be out the protest fees, because such a charge could be laid to inefficiency. However, it might be necessary to demand protest on a large item, and should the operator make the same error, it might prove more expensive and a greater loss than in the other case.

Investments
and
Investment Banking

The Ratio Analysis of Securities

By JOHN STEVENSON

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Address before the Denver Departmental Conference

In this address Mr. Stevenson has outlined certain ratios which have been devised as a valuable means of intelligently interpreting financial statements. One very useful ratio is the "margin of profit ratio." This will vary with different types of industries.

The effectiveness with which a company can employ funds, contributed by bondholders and stockholders, is another measure of operating efficiency. The number of times a year a company can turn over its inventory is a useful measure for analyzing the position of the company.

A useful ratio has been devised by which it is possible to determine the credit policy of a company, the ratio of the accounts and notes receivable to the average net daily sales.

A means of determining the efficiency with which a company uses its fixed property investment is the plant turnover ratio, which may be expressed as the number of dollars of sales in a given year for each one dollar of property investment.

Other items to be considered with great care are the depreciation policy of a company, the dividend policy, and the capitalization set-up.

The current ratio, used for a long time as a means of determining the current financial position, has one outstanding weakness. It includes inventories, and inventories are, in some cases, slow moving and sometimes subject to violent price fluctuations.

The ratios mentioned, and also the price earnings ratio, form a valuable aid in analyzing financial statements.

THE proper interpretation of balance sheets and profit and loss statements is a problem which is constantly confronting investment bankers. The investor who is contemplating the purchase of a security must, of necessity, study the financial statements of a company. By this means only can he determine the relative merits of any securities which he may consider purchasing. In this address I shall attempt to outline certain ratios which have been devised as a valuable means of intelligently interpreting financial statements. The aim in studying the fi-

nancial statements of any company should be twofold: first, to determine the present financial condition of the company and its progress over a period of years; and, second, to compare the company with other companies engaged in the same line of business. The second point is most necessary if the study is to be comprehensive and informative.

MARGIN OF PROFIT RATIO

One very useful ratio which is used in determining the operating efficiency of a company is known as

the "margin of profit ratio." This ratio is computed by dividing operating income by sales, operating income being the amount of earnings remaining after paying all costs of operation, including the cost of the raw materials, depreciation and selling, and administrative expenses. In other words, operating income is the balance available for federal taxes, interest charges, and dividends. A margin of profit of 10% means that from each dollar of sales there is ten cents remaining after paying all manufacturing, selling, and administrative expenses. From the ten cents remaining must be paid federal taxes, interest charges, and dividends on the various classes of stocks, and an amount set aside to surplus.

VARIATION IN MARGIN

The margin of profit ratio will vary with different types of industries. Steel companies will have a relatively low margin of profit, somewhere in the neighborhood of 10%. In contrast to steel companies, good will businesses have a much higher margin of profit. In 1928 Coca-Cola Company operated on a 40% margin of profit, and Canada Dry Ginger Ale on a 30% margin. Generally speaking, the best managed companies in an industry will have the highest margin of profit, or, to express it another way, will have the lowest cost of doing business. This ratio should be studied carefully over a period of years to determine any unfavorable trend. A decreasing margin of profit may be the result of one or all of the following situations: increasing competition, decreasing sales, or laxity on the part of the management in keeping down expenses.

EARNINGS ON INVESTED CAPITAL RATIO

The effectiveness with which a company can employ funds, contributed by bondholders and stockholders, is another measure of operating efficiency. This may be determined by the ratio known as "earnings on invested capital ratio," which is found by dividing net income available for fixed charges by the sum of the bonds, preferred and common stocks, earned surplus, and paid-in surplus. It is customary to exclude capital surplus, since, in a great many instances, capital surplus is merely a bookkeeping item arising through the revaluation of assets. Invested capital, in other words, is the funds originally placed in the business plus earnings not paid out in the form of dividends. The earnings on invested capital will vary among different types of industries, and, in some instances, will vary considerably among companies engaged in the same industry. In 1929 Lambert Company earned 125% on its invested capital. In the same year one of the largest steel companies earned less than 5% on its invested capital. Generally, companies with the largest earnings on invested capital will have the highest margin of profit ratio, and vice versa.

TURNOVER OF INVENTORY

The number of times a year a company can turn over its inventory is a useful measure for analyzing the position of the company. Inventory turnover is found by dividing sales for a year by the amount of inventory as shown on the balance sheet at the end of the year. A com-

pany with a rapid inventory turnover has less of its funds tied up in merchandise, upon which it is earning no return, than a company with a slow turnover; it is also in a more favorable position should the inventory be subject to a serious price decline. This last point is important. An illustration of this can be found in the decline of crude rubber prices, which, in January 1928, were quoted at about 40c. a pound and by June of that year had dropped to 18c. a pound. Practically all manufacturers of automobile tires in the United States reported a deficit for the first six months of that year, due, almost entirely, to the drastic price decline of the raw product.

AMOUNT IN RECEIVABLES OUTSTANDING

A useful ratio has been devised by which it is possible to determine the credit policy of a company—in fact, by means of this ratio it is possible to determine the number of days during which the average account receivable is outstanding. The mechanics involved in arriving at this ratio are to divide annual sales by 365, thus obtaining average net daily sales. The sum of the accounts and notes receivable is then divided by the average net daily sales. If annual sales are \$36,500,000 and the accounts and notes receivable aggregate \$4,000,000, average net daily sales would be \$100,000, which, divided into the \$4,000,000 of accounts and notes receivable, would be forty. This means that a period of forty days is required in which to collect the average receivables. This ratio will vary among different industries and among companies en-

gaged in the same industry. For example, in 1928 one steel company required fifty-two days to collect its receivables, while another steel company required only twenty-two days. Chain stores, because their business is conducted on a cash basis, have a negligible amount in receivables outstanding. While it is desirable that the receivables be collected as promptly as possible, a too strict credit policy may result in a company's losing considerable business in favor of some of its competitors who pursue a more liberal credit policy.

PLANT TURNOVER RATIO

Some companies do not have sufficient sales volume based on the property investment. In other words, a company may be handicapped by having more fixed property than is necessary for the conduct of its business if it does not use this investment to the greatest extent. A means of determining the efficiency with which a company uses its fixed property investment is the plant turnover ratio, which is simply annual sales divided by plant investment. In this connection I usually take the plant at depreciated value since this valuation represents, in most instances, the truer value of the plant. For convenience in interpretation, this ratio may be expressed as the number of dollars of sales in a given year for each one dollar of property investment. This ratio must be interpreted with a good deal of care. It is conceivable that the ratio might show a downward trend over a period of time as a result of rapid expansion in plant. It is obvious that a compensating increase in sales cannot take place immediately, and consequently there

will always be a lag between an increase in plant and a corresponding increase in sales volume. Properly interpreted, however, the plant turnover ratio is a useful means of measuring the effectiveness with which a company can use its plant in securing its due share of the sales of a given product.

DEPRECIATION POLICY

The depreciation policy of a company is important for two reasons. First, since depreciation is set up to provide for the retirement of property when that property has passed its usefulness, it is, by its nature, important. Second, an unduly liberal depreciation policy understates the normal earnings, while an inadequate depreciation policy overstates normal earnings. In judging the adequacy of the depreciation policy, it is customary to compare the amount charged off in a year with the cost of the properties. While it is not only difficult but misleading to attempt to set up standard ratios, it is, nevertheless, possible to judge with a reasonable degree of accuracy the adequacy of amounts charged off to depreciation. It is obvious that a 1% per annum charge to depreciation is ridiculously low when we consider that a 1% charge means that the company expects the property to last for a period of 100 years; and yet I have seen companies depreciate property at the rate of 1% per annum. In contrast to this, certain companies follow an excessively liberal depreciation policy. General Electric Company, while it does not report in its income account the amount charged off to depreciation, does, however, carry its property on the

balance sheet at \$49,000,000, as compared with a cost of \$209,000,000; the property having been depreciated 76% of the original cost. The usual annual depreciation charge on total properties of industrials is somewhere between 3% and 5%. The type of the buildings, the nature of the machinery, and the number of automobile trucks used will all have their effect on the depreciation policy.

The dividend policy should be scrutinized rather closely. A company following a conservative dividend policy is much better fortified against periods of depression than is a company which distributes practically all of its earnings in dividends. The dividend policy may be determined by computing the percentage of net income paid out in the form of dividends. Ordinarily, an industrial company should not pay out in dividends more than 60% to 70% of its earnings. By transferring a substantial amount of earnings to surplus a company has the use of such funds to take care of normal expansion without resorting to the sale of new securities. In the six-year period from 1923 to 1929 Allied Chemical & Dye increased its property account from \$152,000,000 to \$202,000,000, an increase of \$50,000,000, or 32%. This increase in plant account was effected entirely from earnings, without the sale of any additional securities, either stocks or bonds. This example illustrates what it is possible to do in expanding a business out of earnings, and accentuates the importance of a conservative dividend policy.

CAPITALIZATION SET-UP

The method of determining the

capitalization set-up of a company is to divide the amount of bonds outstanding by the sum of the bonds, preferred stock, and common stock. The resultant figure will show the percentage of bonds to total capitalization. If a large portion of the capitalization of a company is represented by bonds, the company will not be in as favorable a position in times of depression as a company which has no bonds or only a small amount outstanding. A company with part of its capitalization in bonds will, in prosperous times, show greater earnings for the common stock than will a company which has no bonds outstanding. This point can best be illustrated by the following example:

A conservative policy dictates that only companies engaged in well established industries with reasonably stable earnings should issue bonds.

THE CURRENT RATIO

For a long time the current ratio has been used as a means of determining the current financial position. In fact, the current ratio was, probably, the first ratio ever used in analysis of financial statements. This ratio, derived by dividing current assets by current liabilities, has, however, one outstanding weakness. Current assets, of course, include inventories, and, as I mentioned above, inventories are, in some cases, slow

	Company "A"	Company "B"
5% bonds.....	\$ 300,000	—
Common stock, \$100 par.....	700,000	\$1,000,000
Total	\$1,000,000	\$1,000,000
Net for interest charges.....	\$ 100,000	\$ 100,000
Deduct: Interest charges on 5% bonds.....	15,000	—
Balance for common.....	\$ 85,000	\$ 100,000
Per share	\$12.14	\$10.00

In the preceding example both companies were capitalized at \$1,000,000, Company "A" having its capitalization divided between bonds and common stock, while Company "B" had only common stock. Both companies were earning 10% on their total capitalization. As long as both companies earn more than 5% on their capitalization, Company "A" will report greater earnings per share than Company "B". Whenever the earnings fall below 5%, Company "B" will show larger earnings on the common stock than Company "A".

moving and sometimes subject to violent price fluctuations. A clearer picture of the current financial position may be had by eliminating inventories from current assets. The remaining assets will then be more liquid, consisting principally of cash, marketable securities, and accounts and notes receivable. The quick assets can then be compared with current liabilities, and expressed in terms of the number of dollars of quick assets available for each dollar of current liabilities. Certain large industrial companies have large cash reserves, which exceed all current liabilities.

For example, F. W. Woolworth Company, on December 31, 1929, had over \$6,000,000 in cash and only \$3,000,000 in current liabilities. After all, the most important single item in a balance sheet of an industrial company is cash. Inadequate cash will seriously handicap any organization and will, sooner or later, place the company in a precarious position. In analyzing an industrial concern, the cash account should be examined very carefully to see if the cash account is decreasing or appears to be inadequate.

The method of considering the investment position of the senior securities is well known. In the case of bonds "the number of times interest charges are earned" is the customary method employed. For a preferred stock "the number of times the dividend is earned" is the usual way. This latter method is open to criticism, especially in connection with the senior stocks of a public utility holding company. In this case the securities which have a claim on the earnings of the system are listed below in the order of the priority of their claim:

Operating Company—bonds	
" " —preferred	
" " —common	
Holding Company—bonds	
" " —preferred	
" " —common	

There are, then, four classes of securities which have a prior claim on earnings ahead of the preferred stock of the holding company. Let us assume, for a moment, the following hypothetical consolidated earnings statements:

Gross earnings \$1,000,000

Operating expenses	600,000
Operating income	400,000
Interest charges — subsidiary company bonds	100,000
Balance	300,000
Preferred dividend—subsidiary company	100,000
Balance	200,000
Minority interest	10,000
Balance for holding company	190,000
Interest charges—holding company bonds	65,000
Balance	125,000
Preferred dividend—holding company	25,000
Balance for common—holding company	\$ 100,000

The balance available for the preferred dividend of the holding company, as shown in this statement, was \$125,000. The preferred dividend requirements of \$25,000 were earned five times. This method, however, fails to consider the prior charges, such as subsidiary interest charges, preferred dividends, minority interest, and holding company interest charges. These prior charges totaled \$275,000. Add to this amount the preferred dividends of the holding company, and the total charges are \$300,000. Since the amount available for the charges was \$400,000, the total charges, including the preferred dividends of the holding company, were earned 1.33 times. This margin of earnings over charges is generally considered to be adequate for the preferred stock of a holding company. However, it gives a truer picture of the position of the stock in relation to earnings than the statement that the dividend was earned five times.

PRICE EARNINGS RATIO

In recent years a great deal has been said and written about price earnings ratio. It is not my intention to advance any new theory or to combat any of the existing theories. I merely want to discuss, in a general way, the price earnings ratio and its value in determining the market valuation placed upon a stock. It is folly to say that all stocks should sell on the same price earnings ratio. The factors which should influence the price earnings ratio are the past history of the company, the character of the management, and the outlook for the future of the business. A stock, the earnings upon which have increased at an annual rate of 25%, with a favorable outlook for the future, is, in my opinion, entitled to sell at a higher price earnings ratio than is the stock of the company whose earnings have increased at only 10% a year with no apparent indication that, in the immediate future, earnings will increase at a more rapid rate. Any one purchasing a stock selling at twenty times earnings believes that the stock will, in the future, continue to sell on approximately the same price earnings ratio. To illustrate this point, let me give you a concrete instance of what I have in mind. Recently, in studying a well known stock which was selling on the New York Stock Exchange at twenty times earnings, I projected the earnings five years in the future. The earnings had increased in the past six years at an annual rate of about 25%. I then assumed that in the next five years the earnings would continue to increase at the same rate. I assumed also that the company would pursue the same dividend

policy. At the end of the fifth year the dividends paid would return 5.6% on the original purchase price. If at that time the stock were to sell at twenty times earnings, the return, by way of appreciation, would have been very large. In fact the stock would be worth well over twice the original cost. If, however, for any reason the stock sold at only ten times earnings, the appreciation would have been only \$3 a share, or about 31½%. This illustration, to my mind, crystallizes some of the risks inherent in buying stocks on a high price earnings ratio.

In an address such as this it is virtually impossible to treat in detail the subject, together with its various ramifications. I have attempted, merely, to present some of the more important ratios which are a valuable aid in analyzing financial statements.

Discussion

THE CHAIRMAN: Mr. Stevenson, in your address you stated that only well established companies should have bonded indebtedness. I wonder if you could give us briefly some of the considerations that enter into the set-up from the standpoint of various classes of securities that companies should or should not have, depending upon the types of business.

MR. STEVENSON: With respect to a company having bonds, the most important factor is really not how many times the company has earned fixed charges or bond interest, but the stability of the earnings of the company. Personally, I should prefer to own bonds in a company which earned interest charges slightly over twice for a period of six or seven years rather than to own bonds in a

company that had earned interest charges five times in one year, one and one-half times the next year, seven times the following year, and perhaps three times the succeeding year. Personally, what I am most interested in is the stability of earnings of the company.

The second factor to consider is the importance of the industry. It seems to me obvious that a company in a new industry should not issue bonds. The newness of the industry and the lack of established earning power would tend to place the bonds in a speculative position.

Analyzing Stocks and Bonds As Collateral Security

By FRED J. McCAULEY

CASHIER OF THE PACKERS NATIONAL BANK, OMAHA, NEBRASKA

Address before the Denver Departmental Conference

Stocks and bonds which are accepted for collateral security must be carefully criticized as to both soundness and marketability. In testing the soundness of the collateral, it is important that we get our statistical information regarding the financial set-up and earning records and so forth, from outside, independent sources, preferably from some of the well known firms which furnish this type of service.

Marketability of the security is of the first importance. It will not serve the purpose to accept a perfectly sound bond or stock, if there is no ready market for it, or if there is only a restricted market, which exacts a penalty in the form of a heavy discount in order to dispose of it.

After a bond or a stock has passed the test of soundness and marketability, we must then decide the loan value of the security. Because of its very nature, the market value depending as it does on the law of supply and demand, in addition to the whims of the buying public and to incidental movements caused by individual circumstances, the loan value must be a variable figure, based on a percentage, established with full protection to the lending bank.

IN considering the subject of stocks and bonds as collateral security, one may realize the importance of a little research into some of its factors, by digesting the following article which appears in *The Trend of Business*, issued by the Continental Illinois Bank and Trust Company of Chicago on May 19, 1930:

"Loans on securities by commercial banks, during the past seven years, outran commercial loans more than 5 to 1, and outdistanced deposits almost 3 to 1. If this trend continues, it will involve changes in loaning technique, in bank policies and management, perhaps in the very structure of the American banking system."

This is rather surprising information, and should attract the attention of all who are directing the loan policies of their banks. Equally significant is the result of further analysis, which is given in the same article, in the following words:

"Loans on securities by reporting member banks of the Federal Reserve System have shown no regular seasonal fluctuation throughout the past seven years. Neither have they shown close correspondence with the sub-normal period of production. But they have made a serious business of expanding at the average annual rate of 16.5 per cent. This increase was more than 5 times as fast as the rate of increase of 'all other loans' and

almost 3 times as fast as the average annual increase in deposits. And no further statistical demonstration should be required as to the process which commercial bankers have been forced to recognize, namely, that business is getting its money more from profits and the sale of its securities and less on the old 60 to 90 day basis.

"Bankers must accept the fact that it was 'normal' during the past seven years for secured loans to increase 16.5 per cent a year while the increase in 'all other loans,' chiefly commercial, was only 3.15 per cent. And an upward trend of secured loans will doubtless continue. The American pioneer spirit has turned, after a 'trust busting' era to ownership in business.

"The peak of secured loans for the period 1923-1929 came in November 1929. The recession to the February 1930 low was 7%. But the February average was higher than any prior to July 1, 1929, and the monthly average of secured loans in April set a new high record for all time. The trend of secured loans during the next five years will continue to be a rate of increase higher than that of commercial loans. This rate may not quite equal the secured loan trend during 1923-1929, but the forces that brought about a 7 year average increase in loans on securities amounting to 16 per cent a year are too deep-seated to be more than checked by a stock market crash."

I have quoted at length from this article, as it shows clearly that a vital change has occurred in the type of loan made by commercial banks in recent years. I feel that this transition is so important that it is deserving of our attention, to the end that we may properly adjust ourselves to it.

The number and amount of secured loans of this description in the bank's note case will vary, of course, according to the location and size of the bank, and the type of credit it is ordinarily called upon to extend.

The small bank, and the bank which has little demand for this class of loan, is not as directly interested as the bank located in the larger financial centers, where the loan, secured by stocks and bonds, constitutes an important proportion of its total notes receivable. But with the increasing use of this means of credit everywhere, we may all profitably look into it a little more closely, and see what safeguards are necessary to protect our loans properly. If we are to keep our collateral loans in good condition, surely we must have the collateral itself kept equally so. The slump in the bond market and the recent collapse of the stock market, have tended to emphasize the importance of more care in accepting stocks and bonds as collateral.

REQUISITES IN STOCKS AND BONDS

What, then, is necessary in properly dealing with this kind of collateral? To my notion we must have a broader knowledge of securities and a deeper understanding of the fundamentals affecting their suitability for bank loan purposes. Bonds and stocks vary considerably in their degree of quality and acceptability as collateral, and we must give them a critical eye to make sure that they measure up to requirements. Ordinarily, collateral is acceptable if it possesses two or three simple qualities; soundness or value, and liquidity or marketability. There are other factors which we can touch on later, but let us first examine stocks and bonds for these two prime requisites.

1. To check the soundness of the security offered we must first

look to the issuing company's balance sheet and earning statement. Analysis of these should be careful and exact, proper weight being given to the various items which they contain. The importance of various figures in these statements varies considerably according to the type of business in which the company is engaged. But each industry, and, in numerous cases, each division of a single industry, has a yardstick, so to speak, by which to measure the standing of a single company engaged in that line of work; and, if the company whose figures we are analyzing does not measure up to standard, its obligation or stock should be judged accordingly. In addition to figures in the balance sheet and earning records over a period of years, we should consider carefully past history, management, and type of business. There is a vast difference between well known, seasoned stocks and bonds of old reliable concerns, and many of the untried speculative issues which have flooded the market in the past year or so, and we should be able to tell them apart, and separate the wheat from the chaff. In this connection, it might be well to emphasize the importance of getting our statistical information regarding the financial set-up, earning records, and so forth, from outside independent sources, preferably from some of the well known firms furnishing this type of service. In this way we shall be more certain of our data, and not run the risk of accepting casual reports or hearsay figures, which may or may not be reliable.

MARKETABILITY OF THE SECURITY OFFERED

2. The purpose of taking collateral is to be able to have something that we can liquidate, in the event of the inability of the borrower to pay his note. Assuming this to be a fact, then it will not serve our purpose to accept a perfectly sound bond or stock, if there is no ready market for it, or if there is only a restricted market, which exacts a penalty in the form of a heavy discount in order to dispose of it. Therefore the market for the security must be definitely ascertained. Find out whether it is listed on one of the big exchanges, and, if so, check back the market record to see whether it has an active demand; also, to discover what its price range has been. If it is not listed, find out whether there is an active and broad over-the-counter demand. Very often securities of unknown companies are traded in but very little, and at times there is no demand for them at any price. Reference might be made at this time to securities of comparatively small local corporations. Although they should not be discriminated against, as in many cases they serve as thoroughly acceptable collateral, care should be taken that sentiment does not take the place of good judgment. In too many cases banks have found that they had to take in these securities when the borrower was unable to pay his note, and have been unable to dispose of them.

After a bond or stock has passed the test of soundness and marketability, we must then decide on the

loan value of the security. Because of its very nature, the market value depending, as it does, on the law of supply and demand, in addition to the whims of the buying public and incidental movements caused by individual circumstances, the loan value must be a variable figure, based on a percentage, established with full protection to the lending bank. It should be decided with due consideration of various factors entering into its solution. If we are enjoying a so-called normal market with comparatively mild up and down movements, and the issue in question is not subject to broad fluctuations, and if in addition we know that the borrower can supply additional collateral or reduce his loan if called upon, we can loan on a fairly high basis, say 70% or 80% for stocks, and 80% to 90% for bonds. However, if the market is unsettled and subject to wild fluctuations, or if a continuous advance has been going on and prices have reached high levels, or if the borrower is incapable of supplying more collateral or cash, we should then insist on more generous margins at the outset, and demand increased protection as the need arises. "An ounce of prevention is worth more than a pound of cure," and the time to prevent our losses on stock loans is at the time the loans are made. It takes considerable profit on a stock loan, even at some of the rates prevailing last year, to pay for a bad loss which might have been avoided by more care and firmness at time of making the loan. I personally believe that it is good banking to let a borrower get his money elsewhere, if he feels that we are too strict in this matter of margins and refuses to pledge the amount requested.

There are several other points which might be touched on, before closing this subject of collateral. One is the proper assignment on the reverse side of the stock certificate or on a separate form. Care should be taken that it is executed in blank and signed in ink; also, that the hypothecation agreement is legal and gives the bank full power to sell the security to protect the loan or any other indebtedness, direct or indirect, of the borrower. If the stock certificate is not assigned properly, the bank may not be able to make good delivery, and a delay or a failure in this matter may prove costly. Also, if the hypothecation agreement is not legally binding, or if the bank's powers are not fully shown, the bank may incur the risk of possible damages, if the security is sold. Another matter is that of proper receipts for both the bank and the borrower in the delivery of securities as collateral. This is especially important for the large bank handling a considerable volume of this type of loan. A well devised system for this detail will save a lot of worry and prevent possible loss.

BANK'S DUTY TO WATCH MARKET DEVELOPMENTS

In closing I should like to add just a few words on the part that a bank might well take in preventing a recurrence of last fall's debacle. In the task of acquiring a broader knowledge of securities and their action marketwise, one necessarily takes a deeper interest in business conditions and trade movements, not only in these United States, but also in the world at large. Watching developments occur, one realizes what

their effect on securities prices might be. When clouds begin to appear on the horizon, let us consult with our borrower, and point out the necessity of retrenchment in his borrowings, in preparation for a possible drop in security prices. Although many banks did this very thing last year, many others did not have the courage of their convictions, and failed to urge upon their borrowers the necessity of curtailment in this respect. I believe that the united cooperation of banks, with the example of their leadership, could make impossible another such experience as that of last fall, with its resultant hardship on the people of this country.

Discussion

JOHN E. WISK (Stock Yards National Bank, Denver): I should like to ask Mr. McCauley how he would judge brokers' loans where there was such a large variety of stocks.

MR. MCCAULEY: I was really expecting this question to be brought up, because I know that brokers' loans constitute perhaps the majority of loans on securities.

The proper care of the securities that are pledged to call loans requires an extremely diligent collateral department. The department must be in constant touch at all times from day to day with market conditions. From the standpoint of the bank, we will say that in the interior call loans have always been regarded as one of the ideal divisions of a secondary reserve. That belief has arisen because of the low loss ratio, extending over a period of years, and because of the fact that, especially in the case of demand loans, the bank can secure its money practically instantly. In most cases, I be-

lieve I am safe in saying that—though it may not be true in the larger banks, it is true in the smaller banks—the call loan is in most cases a participation in the larger loan of the bank that is handling the call loan. So that to a certain extent they enjoy the safety and the care of the bank that is handling these call loans.

E. FLOYD GRIFFIN (Oyster Bay Trust Company, Oyster Bay, N.Y.): You probably loan money in New York City on call. Have you ever thought about just what responsibility these large metropolitan banks take with regard to collateral?

MR. MCCAULEY: Yes, I have. In fact, I made a rather direct inquiry several years ago. Their responsibility is not in any sense a guarantee that these loans will be absolutely 100% safe. They would be foolish to attempt any such thing. The moral responsibility and the knowledge employed—in these days when they are adding a charge for the service, and at previous times when they were furnishing a service incidental to securing accounts of correspondent banks—have necessarily developed a very, very high sense of responsibility. As I said before, I think it would be practically impossible to say that your loan is guaranteed, or that your loan is 100% safe.

MR. GRIFFIN: I was really interested, and I suppose everybody else is, in just what responsibility the bank would take, because there were some loans, in fact, during the last crash, that went below the actual market value of the securities temporarily, until the collateral was in the next day. Everybody was overworked and could not find out until midnight, or the next morning, what the security was worth.

MR. McCAULEY: I hesitate to give a definite answer to that, because I do not know.

SYLVIA M. WATHEN (Liberty Bank & Trust Company, Louisville): Contrasting the attitude taken in years gone by, during our prosperity years, with the rigid attitude taken in the severe crisis—what will be the banker's attitude toward his collateral loan borrowers from now on until the return of prosperity?

MR. McCAULEY: I think it is largely a matter of being taught by experience, and also by education. That is why I think the bank can do a great deal in future years in tightening the requirements considerably in loaning on securities; in order to tighten these requirements and make them effective, they must know more about securities and know all the facts that affect securities. In too many cases I know it to be a fact that in smaller banks for some reason or other a particular stock or bond, as some one else pointed out, seems to have a halo around it. After all, a bond is not different from an ordinary loan. It is an obligation to pay, and the analysis of the security throughout the years, I am confident, is going to continue to be more active and more severe.

MISS WATHEN: I really meant the attitude toward the customer. We built up our confidence with the customer in years gone by. We have to maintain that confidence in keeping that same attitude. Are we going to keep the collateral at less value or make the customer come in and cover up in the meantime?

MR. McCAULEY: In my opinion, the bank is absolutely within its right at all times in seeing to it that loans are properly margined and that the

safety of the loan is kept intact. The fact that the bank makes a loan to a customer on stocks or that he offers stock for a loan is not the only factor that enters into the matter. In addition to having a knowledge of the stock in question, we should know whether or not he is in position to increase the margin of security, or whether he is in position to reduce his loan if need be. What I am getting at, is that the bank at all times is within its right when it insists first that the safety of the loan be kept intact at all times.

MISS WATHEN: If the safety of the loan is not kept intact, what then? Have we got the right to close it out, if we make a mistake in making the loan?

MR. McCAULEY: Of course that brings up factors in taking any loan on security. Is the hypothecation agreement sufficiently broad and does it give full powers to the bank to liquidate the loan if there is still margin?

MISS WATHEN: Morally?

MR. McCAULEY: Yes, indeed. We should not necessarily feel that we should protect the loan even if the value of the security has melted away. We are making the loan on the basis of the security partly, in fact 100%.

ORVILLE M. STREIFF (State & Trust Bank, Highland, Illinois): While we are speaking on the basis of security, suppose that a man comes in and offers sufficient security. At the time you are considering the loan you have the feeling in your own mind that you are going to have to resort to that security. Would you approve that loan or would you throw it out immediately, even though you had sufficient security?

MR. McCAULEY: A good deal would depend on the individual cir-

cumstances. If the security in question was a sound security with a good market, if we were in a market not subject to extremely broad movement—all these factors would enter into the case. On the other hand, if we were in a period where conditions were like those of the past six or eight months, we would do one of two things: We would either make the loan value of that security so low that we would be amply protected or turn down the loan entirely.

JOHN BROWNING (Harris Trust & Savings Bank, Chicago): I should like to ask Mr. McCauley what he would say regarding the desirability of bank stocks as collateral.

MR. McCAULEY: No doubt, you are well aware of, or well acquainted with, the present prices of some bank stocks compared to what they were six or eight months ago. Offhand I should say that I might divide bank stocks into two classes. The first would be the stocks of sound banks which, although not listed on the exchanges, have a ready market, even though at a reduced figure. Such bank stocks would probably come under the same classification as other stocks. In the second class of bank stocks would be found bank stocks which have practically no market. In this class would be a large proportion of the stocks of small banks throughout the country. Individual circumstances will dictate the banker's attitude with respect to loans on such collateral. The borrower's ability to liquidate the loan, if called upon, will certainly be an important consideration when loans on unmarketable bank stocks are being considered. Speaking generally of bank stocks, I believe that they would come under the classification of other stocks.

CLARENCE CROSS (First Union Trust & Savings Bank, Chicago): Mr. Chairman, did I understand the speaker to say earlier in his talk that very often bonds bought for the bank's own account would not be acceptable as collateral?

MR. McCAULEY: Yes, indeed, because quite often bonds of small local corporations fill a suitable niche in the bank's investment account, if it has, as many banks do have, a permanent investment account. A bank may have long time securities which it knows from experience it will not be called upon to liquidate for a considerable number of years; even though there was practically no market for these, they would form a suitable bank investment. Ordinarily speaking, in making a loan, particularly if it is a short time loan, you are not making an investment, although, in a sense, your loans are investments.

The idea in taking a bond as collateral is to be able to sell it in case the borrower cannot pay his loan.

MR. CROSS: Isn't it true that in considering bonds for the investment account marketability is just as essential as collateral for a loan?

MR. McCAULEY: Yes, partly, but not in the same degree as collateral. I would not attempt to set up here what the investment policy of a bank should be, but it is understood and accepted that bonds, on which the market feature is not the vital thing, can be taken into the bank in certain proportion to the rest of the bonds. I will illustrate in this way: Let's take a five- or ten-year bond. The banker, buying such a bond more or less as a permanent investment, to hold to maturity, is not interested primarily in the market of that bond, although he might be called on in ex-

treme necessity to liquidate the bond. Ordinarily, if the investment account of the bank is of sufficient size there may be some bonds of that nature.

MR. CROSS: In my experience I have found that the small bank, too often, in purchasing bonds for its own account, forgets marketability. That is the trouble right now in the Middle West with a great many small banks. I believe the marketability feature is just as big a factor in buying bonds for a bank's account as it is in judging bonds as security for loans.

MR. McCAULEY: I agree with you, still maintaining, however, that if the bank is borrowing \$100,000, \$150,000, or \$200,000, marketability will be a very vital factor in practically ninety per cent of its investments. I am not defending a policy of loaning on unmarketable securities, naturally, but as I said before, in purchasing for the investment account of a bank of large size there is justification in some instances for not making the market feature the deciding factor in the case.

The Investment Policy of Small Banks

By ROBERT L. JOHN

SECRETARY OF THE BANCNORTHWEST COMPANY, MINNEAPOLIS, MINNESOTA

Address before the Denver Departmental Conference

Mr. John believes that the greatest defect in the investment policy of small banks lies in the lack of ability to make the required outside investments to best advantage, and to create and maintain a secondary reserve in the proper condition of liquidity and at the same time to the profit of the bank.

There are three factors which determine the value of a bond, namely, security, marketability, and yield. In purchasing for the secondary reserve of the bank, the principal factor to keep in mind is, of course, security, and it is axiomatic that a bond which is sound and which has been purchased at a proper price can generally be sold satisfactorily in case of necessity.

Too often bankers excuse their errors of judgment in the purchase of securities by an admission of ignorance. What, however, would be your opinion of the chief executive of a railroad who denied any knowledge of railroad operation? The manager of a small bank may conduct his institution very well from the viewpoint of service to his community, and may be in all other respects a competent banker, but if he lacks ability as an investor, he is very seriously handicapped.

AS I approach this subject, I realize that I am entering upon ground that men of ability and long experience have crossed before me. It is a subject the frank discussion of which is likely to stir up any to whom my observations may apply and who are sensitive. But I have some very definite ideas about it. For a number of years before settling down more to an inside desk job I went about, over a considerable territory, in season and out, in good times and bad, making calls on country banks. During this period many deep and lasting impressions were received. On the constructive side, if such were my assignment here, I might tell of

many things reflective of the courage, resourcefulness, and all round ability of the small bank executive.

What I may say about The Investment Policy of Small Banks (constructive as I should like my comment to be) must, however, be from the negative side. If I were asked what was the deepest impression suggestive of the need for betterment, that I received over the period of my actual experience, I should say without hesitation that it was the lack in general of ability to make the required outside investments of the banks to the best advantage and to create and maintain a secondary reserve in the proper condition of liquidity and at

the same time to the profit of the bank.

THE SECONDARY RESERVE

The necessity for a secondary reserve is, of course, so generally recognized that it needs no long discussion. But the means of creating such a reserve, of maintaining it, and of keeping it liquid, are not so well understood. The very fact that there is in a bank a so-called secondary reserve indicates that preparation has been made for something of unusual, perhaps of adverse, nature, which is not expected but which may occur. A secondary reserve is not properly constituted to meet the purpose for which it exists unless it can be utilized upon necessity without causing loss of consequence to the bank. The process of depleting the secondary reserve in case of necessity by sale of bonds for the purpose of strengthening the bank's primary reserve position is simple, but the maintenance of a bond list of such character that when this is done serious losses are avoided is not so easy.

BUYING A BOND IS MAKING A LOAN

The banker himself is usually an expert on local loans. He must manage his bank efficiently and keep up to date on his other assets or he is negligent in his duties. But too often his circle of information does not extend beyond local or district affairs and he is faced with difficulty and is very largely dependent upon advice when he himself enters the bond market. No banker would like to confess that he knows little or nothing about making loans; it would be an acknowledgment of his incompetence.

And yet I have heard many a banker frankly admit that he was in deep water when he got to buying bonds and that he did not understand how best to do it.

When a banker buys a bond he is really making a loan. There is this difference about the two transactions, however: that when local borrowers come to him, if he does not like what they propose and if the accommodations asked for do not look safe to him, he need not make the loan. This is as far as he can go. If there are people in his town who are very sound financially and to whom he would very much like to make loans, but who do not need to borrow, there is little that the banker can do about it. When it comes to making loans, however, in the form of buying bonds, he has the whole world before him; and it lies within the banker's own choice who his borrowers shall be. Too often he is confused by the multiplicity of issues and the various differences between them, and, finding it a very big and technical subject, he passes it up altogether and depends upon the advice of some one who approaches him in the capacity of a salesman.

BONDS MUST HAVE CONTINUAL CHECKING

Confidence in the strength of his institution is no excuse for the small bank manager's relinquishing his vigilance as to his paper or his bonds. His bonds carefully held in the vault or in safekeeping require the same continual checking and thumbing over that his note pouch receives. He must be assured of their continued strength and marketability. Funds that are frozen in unmarketable bonds are not

reserves. In a banking sense reserves are resources in the background, liquid or nearly liquid in character, that can be moved up to the emergency line when necessary, with no delay or appreciable loss.

What, then, are some of the things that are most essential?

For the purposes of this discussion, it will be necessary to assume that proper reserves of cash, commercial paper, and acceptances or government bonds and treasury certificates are maintained. The cash reserve is required by law. These other reserves are dictated by good banking judgment, and should be carried and held in the proper proportions in order that the bank may properly care for its seasonal fluctuations without taking recourse to the more permanent type of investment. The bond reserves, essentially, are a higher earning asset, and are a backlog or supplementary force to the cash or short time paper reserve, but they should be regarded as in no way replacing the former, except as bond maturities come within six months of due date, when the bonds may be considered virtually the same as commercial paper.

SECURITY, MARKETABILITY, YIELD

There are three factors which determine the value of a bond, namely, security, marketability, and yield. In purchasing for the secondary reserve of the bank, the principal factor to keep in mind is, of course, the security, and it is axiomatic that a bond which is sound and which has been purchased at a proper price can generally be sold satisfactorily in case of necessity. The banker must apply himself to the careful and conscientious study of investment principles and

analysis in order that he may properly analyze and determine what satisfactorily constitutes a good security and a proper one for him to buy. He must understand the marketing of securities in order that he may be able to determine those which are likely to have a satisfactory market at the time when he wishes to sell them. And he is also charged with the responsibility of making satisfactory earnings for his bank, and his managerial ability is directly reflected in the average yield on his bond account, purchased both for the purpose of a secondary reserve and for investment. It would be, of course, a very simple thing for any one of us to purchase for these purposes United States Government treasury certificates maturing inside of six months, but the yield is low, and, as we get away from this accepted standard of highest quality, we may expect to receive the reward for study of bond values. It is very essential, both for the regular investment account and for the secondary reserve, that for the proper maintenance of liquidity and profit the cardinal principle of diversification be adhered to. It is of prime importance that the account of which we speak, be so diversified as to geographical location, as to type of security, and as to maturity, that serious upheavals in our economic world cannot affect us adversely to the extent of our entire holdings.

A THEORETICAL MATURITY DISTRIBUTION

Not only is it very difficult, but it is really impossible, at any time, to propose a definite program which satisfactorily meets the conditions of all institutions. However, for the purpose of providing a yardstick or rule

of thumb, I am going to outline a theoretical maturity distribution, which, to the average bank in the average year, should prove most satisfactory and expedient. For the bank which is purchasing for secondary reserve and investment purpose as well, let us assume an account of average proportions against deposit liabilities of, say, not over \$2,000,000. For this bank let us propose an account of approximately \$800,000 (it should be distinctly understood that this does not mean that all banks should invest 40% of their deposits in bonds), of which \$600,000 shall mature within five years. Of this \$600,000 there shall be \$300,000 maturing within the first two years. The remainder shall be evenly distributed in the third to the fifth year. The balance of \$200,000 may well be invested in sound securities of ready marketability maturing over a longer period. It is essential, further, that in the reinvestment of maturities from this schedule, the original basis and program be borne in mind and the same proportions maintained, except, of course, when bond prices are seriously depressed as a result of periods of high interest rates, when longer term bonds may be purchased, to be converted later into shorter time securities when more normal conditions have been reached. Here, again, a very definite reward awaits the banker who carefully studies interest rates and the rise and fall of bond prices, and observes the practice of the purchase and sale of long term securities, with the resulting profits accruing from the careful handling of his bond account in this way. In considering the fundamentals to which attention must be given in analyzing the security back of the issues which he is purchasing, the

bank manager must first deal with investment banking houses of sound management and integrity. No investment banking house pretends to be infallible, and none can guarantee its judgment. They are recommending merely, after the most careful consideration of all factors bearing on the situation; after exhaustive examination upon the part of reputable attorneys and accountants; and then only entering upon a program of merchandising at a price that is fair, in their opinion, both to the borrower and to the purchaser of the investment. The investment banking house which can give you this service need in no sense of the word be large or nationally known. But the banker should make certain that the house observes the standards that he must necessarily observe in the successful conduct of his own institution.

THE BANKER MUST HAVE ABILITY AS AN INVESTOR

Too often bankers excuse their errors of judgment in the purchase of securities by an admission of ignorance. Let me ask your opinion of the chief executive of a railroad who denied any knowledge of railroad operation. What faith could stockholders have in the management of their business if its chief executive were acquainted with only half his job? The head of any business is charged with the responsibility of its successful operation and must have more than a speaking acquaintance with its every phase. Modern business demands the exercise of sound judgment and the recognition of sound principles. The manager of a small bank may conduct his institution very well from the viewpoint of service to

his community, and may be in all other respects a competent banker, but if he lacks ability as an investor, he is very seriously handicapped.

We have necessarily omitted from this discussion of the investment policy of a small bank anything but passing reference to local loans. That is a subject big enough for a dozen chapters. Neither have we referred other than incidentally to such assets as cash, or those investments maturing within six months, for sound banking practice dictates their use.

To cover sufficiently and adequately all the phases of our topic would require many chapters of a good-sized book. I have attempted to impress upon you the growing importance of sound investment knowledge as it pertains to the safeguarding of the balance of your depositors' funds, and to illustrate briefly some of the more important features to be considered.

If I have left with you any thoughts of value, which will cause you to be better equipped in this respect for your banking future, I shall feel more than adequately compensated for the effort of preparation.

I am sure that the responsibility of the future will rest more lightly on those of you who today recognize the necessity for an understanding of this problem and who, therefore, prepare yourselves.

Discussion

THE CHAIRMAN: Would you say that a bank should have a fixed limitation on the amount of real estate paper it will carry; if the local demand should exceed that limit, what should be done with the excess?

MR. JOHN: I think there should be a very definite limit on it and I

think it should be quite low. Suppose somebody had come to you twenty years ago and said, "I have \$100,000 and want to establish a trust. Farm mortgages have been the medium of my investments for a good many years, and I have never lost a penny. I am afraid of bonds; afraid of everything but mortgages. They are always good. I can always get my money for the land if I have to take it."

I have in mind an account of that nature. Most careful judgment was used in the purchase and selection of the mortgages which went into that account. The principal of the account is composed of about \$20,000 in good mortgages. The balance is in land, and the income from the \$20,000 of good mortgages plus the earnings of the land barely carries taxes and other expenses. I think that there is no question of course but that there are a good many mortgages which can be readily sold to some insurance company or to investors, but should the bank be placed in a position where it is necessary to realize upon its assets to take care of heavy demands or falling deposits, the situation might prove embarrassing. It is a situation approaching a frozen condition, because, although the loan may be good, the interest may be paid, and you may have every expectation of receiving your principal when it is due, in case of necessity it might be difficult to get your money. Every piece of paper that we take into our bank we must figure on liquidating at some time or other. After all, it is not our money we are loaning; it is our depositors' money. I think it should be the policy of a bank to limit the amount of local loans in the form of mort-

gages on real estate which it will make.

THE CHAIRMAN: I have in mind a banker, the president of a country bank, who had loaned very heavily on farm mortgages, and some urban mortgages; suggestion was made that in the future he place a limitation on the amount of money he would lend on mortgage security. The suggestion was also made that he could take care of the excess demand by placing mortgages with an insurance company or some other outside agency. The banker replied that he would never do that, because such action would be a reflection upon his bank's financial standing in the community and the bank's ability to serve the community.

MR. JOHN: It is not necessary for him to make all the loans in the community in order to give the impression that his bank is sound and safe.

MR. CROSS: Have you a formula as to the proper diversification of types of bonds?

MR. JOHN: As to industrials, utilities, and railroads?

MR. CROSS: Yes, sir.

MR. JOHN: That is very difficult. The bond market has its swings. One period will run strong to rails; at other times the tide will run strong to industrials or utilities. During the past four months, for example, there have been a lot of railroad securities issued, both equipment and mortgage.

In my opinion the banker should not attempt, in spite of all the statistical information given out, to maintain exact ratios in diversification. As a general proposition perhaps we might outline a plan of distribution, but I do not want to accept it under

any circumstances as a rule of thumb. A plan of distribution which would fit one bank might be entirely improper for another.

In general, railroad securities are of the very highest grade. They are probably more stable as a class than any other type—railroad equipment in particular. At the same time, and in logical sequence, the yield is lower. Because of the low yield we might not want to put as much in railroads as in another class bringing a higher yield. Let's say that we put 15% in rails. The bank's holdings of municipal securities will depend largely upon how much of these securities the bank is holding as collateral. It is a very common practice, as you know, to deposit bonds of one's own city, county, or state to secure the deposits of the school district or some other political subdivision. It is almost impossible to judge what amount of municipals should be purchased. It will depend entirely upon the local situation.

Public utility securities can occupy quite a prominent place. By public utility securities I mean securities of operating companies, not holding companies. Holding companies, I think, are far better for the individual investor than for the bank. It should be understood, however, that I am speaking of them as a class; there are plenty of good holding company utility bonds that are far better than the obligations of a good many operating companies. Let's say, as a rough estimate, that the bank should purchase 30% of utilities.

Next we come to industrial securities. I am quite an optimist. I think you have to be to sell securities or anything else for that matter. Industry in this country is going to

prosper. It is going to have its peak periods and its low periods, but after all, the obligations of sound, well managed industrial concerns are safe, provided they are companies engaged in the production and distribution of necessary commodities. I think that is quite essential. As Mr. Stevenson pointed out very fairly, it is rather difficult for the bond owner to hold the bag on good will. That is the stockholder's privilege. He gets paid for it. The bondholder has a fixed income and in case of extreme prosperity he gains nothing. Industrial securities, I think, could occupy the same percentage, 30% to 35%.

The balance could be made up of your municipals and long time governments.

E. FLOYD GRIFFIN (Oyster Bay Trust Company, Oyster Bay, New York): I was just going to ask a question about differentiating between the country and the city bank. Of course, in the country bank, you have the unsecured loan to cope with. Your interlocking loans can be analyzed very readily. But would you advise the establishment of a credit bureau in order to catch the multiple borrower?

MR. JOHN: You are speaking of the country credit organizations?

MR. GRIFFIN: Yes.

MR. JOHN: I am quite a believer in a movement which is being sponsored by a number of outside bankers in Minnesota in the county credit bureaus, for the reason that I know of some instances where bankers have sat down together, compared their lines, where they were suspicious, and found multiple borrowers. It is a good business practice. In fact modern business is such that we do not need to be afraid of our com-

petitor except in so far as he is more active than we are, more aggressive. That is the only thing we have to be afraid of. Both ourselves and our competitor will gain by sitting down and discussing our problems. We do not know it all; neither does he. At the same time we may be able to give some information that is going to help him and get something in return. I think it is very good business practice for competitors to discuss their problems, most essential, I think.

ORVILLE M. STREIFF (State & Trust Bank, Highland, Illinois): Recently we established a credit bureau in our territory and the results are amazing. We interchange, and we have worked out a very fine system. Once you have organized such a bureau you soon find that you have duplicate, triplicate borrowers, men borrowing in four or five banks. I do not see how any bank or group of banks can hope to get on any longer unless they establish a credit bureau of some kind in the very near future.

MR. JOHN: I think the banks are responsible to some extent for that condition. A man lives in a town, "A," we will say; "B," another town, is nearby; another is over here, twenty miles away, town "C." Bankers in "B" and "C" are reaching out into "A's" territory. If they make a loan to a man who lives in "A's" banking territory, they are charged with the knowledge of the borrower's condition. I think the multiple loan is quite inexcusable.

SYLVIA M. WATHEN (Liberty Bank & Trust Company, Louisville): This situation recently resulted from buying bonds from a house in the East that failed. The bond had been guaranteed by a very prominent

company of the East and I think extensively sold in the West. Naturally this left an impression of doubt as to what one would consider really safe bonds.

MR. JOHN: I do not think you ought to be so easily discouraged. As I said, there is no banking house that can guarantee its judgment. There is such a thing as fraud that has cropped out in some cases, which the most careful accountants would be unable to catch. That is going to happen just as long as you loan money. The thing for you to do is to hew close enough to the line so that your risk is minimized. You have to expect loss. A bank is not foolproof. Neither is any other business. And to expect to make it so is wishing for the Utopia I do not believe you will ever reach.

MARTIN H. MALECKI (Irving Park National Bank, Chicago): Do you think the country bank ought aggressively to promote that class of securities to the bank's customers?

MR. JOHN: By all means. There are two which I know very well, of about the same size; one bank makes half again more money, and is cleaner, finer in every way. A man comes in to borrow money and lays down bonds that he bought two years before at the bank. It is a very profitable source of business. If the country banker is going to survive he must recognize and utilize every channel of earnings.

MR. MALECKI: But purchasing securities and analyzing securities may be apart from his own field. Take industrials for example; they are apart from the field of the average country banker.

MR. JOHN: He must make them

a part of his field today. He must recognize that it is necessary for him to do so to keep in line with modern trends in banking. I am convinced of that. I have seen it work out in too many cases. I can go back fifteen years and name fifteen bankers who told me at that time, "I would not buy bonds for anything. I can get 8% locally." These banks were loaded, depression came, and what happened? The banks are closed today. Not one of the fifteen is still open. I just want to illustrate what the possibilities are in the careful handling of a bank bond account. Pardon me for getting off the subject just a little bit, but I think it is extremely interesting. The Northwest Bancorporation with which I am connected, as you know, has been very aggressive in adding to its banks. I am going to tell you about a bank that came in October eighth. The fourth of October, according to the Dow-Jones bond averages, marked the low point for bond prices in about two and a half years. This bank came in on the eighth of October, last fall, with a bond account of \$900,000. I would rather take that bond account as a rule of thumb for diversification, type, and maturity than any other I know. Perfection was revealed by an examination of the account and a check of the values. According to the figures, they had a net depreciation of \$37. Contrast this with another bank that I know with a bond account of \$500,000 and a depreciation of \$60,000. That shows what can be done by using your head, knowing what you are doing, and not being attracted too largely by high rates and delightful stories.

The History and Future of Federal Land Bank Bonds

By WOOD NETHERLAND

PRESIDENT OF THE FEDERAL LAND BANK OF ST. LOUIS, ST. LOUIS, MISSOURI

Address before the Denver Departmental Conference

Mr. Netherland, in outlining the history of the Federal Land banks, explains some of their earlier difficulties, as well as their present mode of operation, and their relationship with the Federal Farm Loan Board, the Federal Farm Loan Bureau, and the Treasury of the United States.

He has complete faith in the future of the Federal Land banks. In his own words: "It is reassuring to be able to say that, while some of the banks are faced with difficult problems, most of them are in a sound and healthy condition. The system has weathered trials that have tested its strength during a most crucial period. Its achievements and services have demonstrated its fundamental soundness and usefulness. Taking all of these factors into consideration, it would seem that faith in our nation, faith in the fundamental soundness of our farm loan system, and faith in the farmers who constitute the bulwark of our national strength, would fully justify confidence in the future growth and progress of the system."

WITH the exception of government bonds, there is perhaps no one class of outstanding securities which has obtained a more general distribution in the investment field than Federal Land bank bonds. As the so-called war debt is retired from year to year, for which there must be substituted securities having certain preferred features, it is reasonable to assume that Federal Land bank bonds will forge gradually to the front and come more and more into demand. Since present market prices afford an attractive yield to the investor who looks into the future, it is quite fitting that an investment division of a group of bankers such as this should give consideration to the history of these bonds and their future importance in the investment account.

Federal Land bank bonds, as to both principal and interest, are exempt from federal, state, municipal, and local taxation. They are lawful investment for fiduciary and trust funds under the jurisdiction of the United States, and eligible for investment by savings banks in most states. They are also acceptable to the United States Treasury as security for government deposits, including postal savings.

THE BASIC COLLATERAL OF FEDERAL LAND BANK BONDS

The basic and underlying collateral insuring their eventual payment is the first mortgage on selected farm units. From time immemorial, land used for agricultural purposes has been regard-

ed as offering the best kind of security, and, notwithstanding the unhappy era through which we have passed during the last ten years with respect to agriculture, man must always depend upon the products of the soil for sustenance. The collateral, therefore, sustaining these bonds, represents a lien on a national asset which has been the foundation of our republic and which constitutes a guarantee of its continuance.

Since each Federal Land bank bond is not only the primary obligation of the bank of issue, but, under conditions stated in the law, is likewise the liability of the other eleven Federal Land banks, as to both principal and interest, a history of these securities must to a large extent be interwoven with a history of the Federal Land bank system itself.

Federal Land bank bonds are issued with the approval, both as to form and security, of the Federal Farm Loan Board. The law requires that they be secured, dollar for dollar, by the deposit of first mortgages on farm lands, representing not more than 50% of the appraised value of the lands and 20% of the appraised value of the permanent, insured improvements, or by United States Government bonds. Under the conditions stated in the Federal Farm Loan Act, they are guaranteed jointly by the twelve Federal Land banks, with total capital, reserves, and undivided profits of approximately \$100,000,000.

FEDERAL LAND BANK BONDS SAFE

Federal Land bank bonds have all the safety of a first mortgage plus the guarantee of the twelve banks. Aside from the "amortization" payment,

which annually or semi-annually reduces the principal, each bank may charge borrowers interest at a rate not in excess of 1% above the interest rate borne by its last issue of bonds, at the time the loans were made, to provide for operating expenses, the absorption of losses, and the creation of reserves.

The farms upon which loans are made through national farm loan associations have been twice appraised: first, by a local committee composed of members of the national farm loan association which guarantees the loan; second, by an appraiser appointed by the Federal Farm Loan Board.

The set-up of the Federal Land bank system is somewhat analogous to that of the Federal Reserve System. For each there is a board at Washington acting in a supervisory capacity, and in each system the country is divided into twelve districts, which, however, do not cover the same areas. National farm loan associations take stock in and do business with the Land bank of their district in a manner somewhat comparable to that in which state and national banks have an interest in the Federal Reserve banks. There are 4,657 national farm loan associations having stock in the banks, one association or more to practically every agricultural county in the United States.

NATIONAL FARM LOAN ASSOCIATIONS

Each association appraises the security back of, indorses, and becomes liable for, each and every loan accepted through it by the Federal Land bank of its district. These associations vary in size from ten member-borrowers with a total of \$20,000 in

loans, to more than one thousand members with loans aggregating \$5,000,000. Each borrower is required to take stock in his local association in an amount representing 5% of his loan, and is equally and ratably liable for the association's obligations in an amount equal to his stock holdings. In other words, the stock carries the double liability feature, as does stock in national banks.

The national farm loan associations have acquired \$64,723,607.50 of the capital stock of the twelve Federal Land banks. The initial capital of the twelve banks was \$9,000,000, of which \$8,892,130 was subscribed by the Government; all but \$292,519.25 of the latter amount has since been retired. The legal reserves and undivided profits of the Federal Land banks approximate \$17,760,000, and, in addition, the banks have reserves set aside against particular assets, such as real estate, delinquent instalments, and so forth, amounting to more than \$16,400,000. They have paid dividends aggregating more than \$25,000,000.

Each national farm loan association has its officers and board of directors, just as does any other corporation, and each is a distinct entity. The association receives applications for loans and makes such investigations as it may deem necessary as to character and solvency of the applicants and the sufficiency of the security offered, and submits a written report of the result of such investigations. Upon receipt of this report, the application is either rejected or sent, with written approval of the association, to the Federal Land bank. The bank in turn refers the application and report received from the association to a trained appraiser appoint-

ed by the Federal Farm Loan Board. This appraiser then inspects the property and makes his report thereon in writing. The application, together with the report of the association and the Land bank appraiser, is then submitted to the officers of the bank for approval or disapproval. The Federal Land bank officials cannot make any loan which is not approved by the association, or which is reported on adversely by the Land bank appraiser; nor can they grant any loan for an amount in excess of that which either has recommended. After the loan has been made by the Federal Land bank, it is submitted to the Appraisal Division of the Federal Farm Loan Bureau at Washington, where it must receive final review before it is approved as collateral security for Federal Land bank bonds.

EXAMINATION OF FEDERAL LAND BANKS

The Federal Land banks are examined at least twice each year, and the national farm loan associations at least once, by the examining division of the Federal Farm Loan Board; and out of an experience of some twenty years in both state and national banks, I think I can say with some degree of certainty that the Farm Loan Board as now constituted is fulfilling its duty most efficiently in this respect, and that the manner in which the Board and the banks cooperate in following out suggestions for improvements made by the examining division augurs well for the system.

Such, briefly, is the background of the Federal Land bank system, which, on March 31, 1930, had bonds outstanding in the amount of \$1,184,686,640, aggregating \$1,196,131,-

126 mortgage loans; and combined capital, reserves, and undivided profits totaling more than \$100,000,000.

All these loans have been made on an amortized basis, and, since a relatively small percentage of the loans now outstanding was made when prices of farm lands were the highest, it is reasonable to assume that, having withstood such radical changes in economic conditions affecting agriculture as have obtained in the last ten years, they are for the most part "seasoned" loans. Appraisals made in more recent years have been on a sounder basis than those in the early years of the banks' operations. This has been due in part, of course, to the general deflation in values that has occurred, but primarily to closer supervision of this important work through reviewing appraisers in the field, through the selection and maintenance of a high grade corps of appraisers, and through a more careful investigation of drainage, irrigation, and related problems which sometimes present unusual hazards with respect to farm lands.

THE FEDERAL LAND BANK AND THE UNITED STATES TREASURY

In the early days of the Federal Land banks, the United States Treasury subscribed to practically all of the initial stock of the banks, with the provision that when the volume of loans reached a certain point, the Treasury would be reimbursed by the banks, each institution setting aside for this purpose one-fourth of the funds derived from sale of stock to national farm loan associations. But the banks at that time were confronted with a more serious problem than the sale of stock. Not only was co-operative first mortgage credit new in

this country, but the banks had not been long in operation before the bond market was upset by the entrance of the United States into the World War and the attendant government financing. A temporary syndicate of investment bankers and brokers was formed, and between the first and second liberty loan issues, \$30,000,000 in farm loan bonds was sold easily at a substantial premium.

When the United States actually entered the war, the Treasury Department recommended to Congress that it be granted authority to purchase farm loan bonds from time to time for the succeeding two years, subject to redemption and sale by the banks at the same price. This request was repeated in November 1917, and on January 18, 1918, the amendment was approved making \$100,000,000 available in the Treasury for each of the two fiscal years. Under such authority the banks sold to the Treasury, not counting those bonds repurchased during the period, approximately \$60,000,000 in bonds, and between the third and fourth liberty loan issues the banks sold, through a syndicate of a hundred or more large investment houses, \$56,000,000 in bonds.

LITIGATION PENDING IN THE SUPREME COURT, 1920

In 1920 the loaning activities of the banks practically ceased because of litigation pending in the Supreme Court, involving the constitutionality of the Federal Farm Loan Act, and these activities were not renewed until after February 28, 1921, at which time the Supreme Court confirmed the constitutionality of the Act. Concerning this litigation the Secretary of the

Treasury said, "The effect of this decision was to establish the Federal Farm Loan system firmly as a part of our financial system."

Loaning activities were resumed in June 1921 with the sale of \$40,000,000 in bonds bearing 5% interest. At this time Congress made it possible to sell bonds with a ten-year instead of a five-year callable period. Later in that year another offering, \$60,000,000 of 5% bonds, was quickly absorbed by the investing public.

During the period of litigation above referred to the interest rates on farm mortgages were high, and there accumulated in the banks a large demand for loans. During 1922 the banks sold \$278,650,000 of bonds. This was somewhat in excess of the demand for loans, so that \$70,150,000 was used to repurchase bonds held by the Treasury, reducing its holdings to \$112,885,000. Of the bonds issued in 1922, \$75,000,000 worth of 5% bonds was quickly taken by the public at a premium of $1\frac{1}{2}\%$. The offering of $4\frac{1}{2}\%$ bonds in May of that year was oversubscribed, and a portion of the funds derived from that sale was used to make further purchases of bonds held by the Treasury Department. On March 31, 1930, the Treasury Department held Federal Land bank bonds in the amount of \$101,750,000, representing an investment of United States Government life insurance funds.

In 1923 bonds were sold to the amount of \$232,945,000, a part of which was used to retire Treasury holdings, and since that time the remainder of the bonds bought by the Treasury during the war has been repurchased by the banks. As I stated

before, all of the capital stock originally subscribed by the Treasury has been retired in the manner provided by the law, with the exception of small holdings in two of the banks. Since 1923, the banks have continued to sell their bonds in amounts dictated by their needs for loan funds, their issues in November 1927 and 1928 bearing the record low coupon rate of 4%.

INFLUENCE OF STOCK MARKET OPERATIONS

The stock market operations in the past two years and their influence on all fixed investment securities are too recent and well known to come under the heading of history. Even government bonds failed to escape the influence of these operations. Federal Land bank bonds, however, have staged a substantial recovery, which has demonstrated the conviction upon the part of the bond-buying public and investors that the system is sound.

Such is the history of the sales of Federal Land bank bonds, which have aggregated in a brief thirteen years \$1,599,465,850. But a mere recital of the sale of these bonds, convincing as it may be as to the belief in their desirability on the part of the investing public, is only a part of the history after all. The growth of this, the greatest cooperative farm mortgage institution in the world, would provide a first class human interest story, indeed, had I the time to develop it. To my mind there is one outstanding fact that towers above all others as indicating the soundness of the twelve Federal Land banks as a system. These institutions started from "scratch," and, after they had been launched out on an uncharted course

and before they had an opportunity to accumulate reserves in any volume, the farmers of the country were plunged into the most depressing era agriculture has experienced for over fifty years. Under such conditions some delinquencies and foreclosures were inevitable. The banks, however, not only have been able to withstand the resulting losses, but their loan mortality record compares most favorably with that of other farm mortgage agencies, some of which have been in the farm mortgage business for three-quarters of a century.

LIFE INSURANCE COMPANIES AS COMPETITORS

Life insurance companies constitute one of the most important classes of competition with these banks. Data for eight of the largest companies having substantial investment in farm mortgage loans have been obtained from their reports for the year 1929, made to, and on file in, the insurance department of the District of Columbia. These eight companies, on December 31, 1929, held farm mortgage loans aggregating \$1,333,000,000, which exceeded the net mortgage loans of the twelve Federal Land banks by only about \$100,000,000. The reports of these companies showed that on this date they held acquired farm real estate having a current market or reappraised value of over \$57,000,000. The ratio between this amount and the total of farm mortgages in force was 4.3%. On the same date the twelve Federal Land banks held real estate owned outright in which they had an investment of \$23,200,000, less than one-half the market value of the real estate owned by these insurance com-

panies. The ratio between this investment and the banks' net mortgage loans was only 1.9%.

The value of the real estate owned by Federal Land banks corresponding most closely to that given for the insurance companies is the carrying value before deducting reserves, namely, \$16,687,000, which represented a ratio of only 1.4% to the loans outstanding. On the basis of these figures it is evident that in proportion to the amount of loans held by Federal Land banks, insurance companies owned over twice as much real estate, measured on the basis of either the carrying value or the investment. It should also be specifically borne in mind that the combined statement of the Federal Land banks, as of March 31, 1930, discloses sufficient reserves and undivided profits on hand to charge off wholly not only all real estate acquired but all sheriffs' certificates and judgments as well, without impairment of capital stock.

I shall not burden you with additional data, to show that if the statistics concerning these eight life insurance companies (which, according to available evidence, hold over one-half of the total amount of farm mortgages held by all insurance companies) are typical of all insurance companies, then the record of the Federal Land banks is much better, with respect to foreclosures, real estate on hand, and present rate of acquisition.

REORGANIZATION OF THE FEDERAL FARM LOAN BUREAU

The Federal Farm Loan Board was reorganized on May 10, 1927, and during the intervening period of over three years its supervisory organization, the Federal Farm Loan

Bureau, has been practically reconstructed and placed in a position to meet its responsibilities, both in the discharge of its daily duties and with respect to some unusual situations which arose in the system. The magnitude and importance of this work cannot be overestimated, and the sacrificial manner in which the present members of the Board have addressed themselves to the task of improving the system entitles them to the support and gratitude of all those who are interested in its future.

In the thorough reorganization that has taken place the functional structure of the Bureau has been materially changed. New divisions have been created, old ones strengthened and reformed, and the personnel of the system, both in Washington and in the field, has been enlarged, improved, and mobilized into a trained and energetic force, so that as a result the Board is now equipped to give the system that close and constant supervision contemplated by the Farm Loan Act. The reorganized Board has viewed the system as a great business institution and has felt that its supervision should be conducted in accordance with the principles of sound business administration and practice.

Unquestionably, the reorganized Board has been fully aware of the difficulties that have confronted and still confront agriculture as a result of the inevitable readjustment that followed the war. They realize that the fundamental problems of this great industry are varied and complex and are rightly matters of national concern. On the other hand, it must be remembered that constant and sweeping declarations of pessimism during the past several years have tended to convey the impression that all farmers are in-

solvent, which is untrue. The great majority of farmers in this country are upstanding citizens who meet their obligations, as is very clearly demonstrated by the experience of the Federal Land banks.

IMPORTANCE OF FORESIGHT AND SOUND JUDGMENT

While agricultural conditions, as I have said, are an important factor in the operation of a Federal Land bank, nevertheless these adverse circumstances have not presented unsurmountable difficulties in well managed institutions. Foresight and sound judgment in the conduct of the well managed institution have resulted in the avoidance of much trouble which otherwise would have arisen. The lack of these qualities in a poorly managed bank had resulted in the acquirement of a large amount of distress. In these latter cases the management has been reorganized and strengthened by the directors of these banks, with the cooperation of the Federal Farm Loan Board. Every effort has been made to obtain the best men available, and these institutions have been placed in a position to deal more effectively with their problems.

The effects of the reorganization will undoubtedly be of enduring benefit and will tend to insure the strength and stability of the banks in the future. The errors and omissions of the past must serve as guides for the years to come, and in the light of these experiences there should be no recurrence of the conditions existing prior to the reorganization. It is reassuring to be able to say that while some of the banks, as previously indicated, are faced with difficult problems, most of them are in a sound and

healthy condition. The system has weathered trials that have tested its strength during a most crucial period. Its achievements and services have demonstrated its fundamental soundness and usefulness. Taking all of these factors into consideration, it would seem that faith in our nation, faith in the fundamental soundness of our farm loan system, and faith in the farmers who constitute the bulwark of our national strength, would fully justify confidence in the future growth and progress of the system.

Discussion

CHAS. EMERY (Central Securities Company, Denver): Is every mortgage you hold guaranteed by an association?

MR. NETHERLAND: Yes, every mortgage the Federal Land bank accepts is guaranteed by the association which takes it.

MR. EMERY: The fact that you own a lot of land would indicate that some associations have failed. Is that true?

MR. NETHERLAND: No. We take these farms over ourselves because the associations do not have the funds to take them over. They have no funds on hand except their reserves. Then we enter into a contract with the association that we will sell these farms. If we sell them at a loss they will guarantee our loss, and if we sell at a profit they get the benefit of the profit.

There are always more defaults the first six months of the year than at any other time. Last year we sold more farms from January first to July first. We sold six or seven times as many farms as we had in previous years. Last year we got out of our

farms 76% of our investment and 66% of the original loan. Of course, sometimes it takes about 10% added there for foreclosure costs, court fees, and so forth. But that is the average, 76%. So on some farms we sell we make a profit. On most of them we take a loss. A few farms we have to abandon entirely on account of confiscatory taxes. But that is a subject in itself.

Of the average income from the farm at the present time, 30% goes for paying taxes. There isn't any sort of industry that can prosper and pay 30% of its income as taxes. That is only the average. Some places are paying as high as 50%; in some places they are abandoning the land.

VICTOR B. ROGERS (First National Bank, Waco, Texas): From the viewpoint of the borrower, what is the justification for the formation of an association?

MR. NETHERLAND: Well, in the first place, cooperative credit has always attracted the lowest rate of interest. It is estimated that these cooperative farm mortgage institutions have reduced the average interest cost on farm mortgage indebtedness by about 2% annually. In other words, the farmers of this country, by the institution of their own system, have saved over \$200,000,000 annually on their interest bill, to say nothing of the commissions they have to pay every time they renew their loans. The average rate they are getting is cheaper than they can get outside, to say nothing of what they have saved in commissions.

If a farmer were to lose all his investment in an association, he would still have a lower rate of interest than he can get anywhere else. He keeps control of the market.

MR. ROGERS: He has got the assumption of a liability there.

MR. NETHERLAND: He is assuming 5% in all.

MR. ROGERS: Isn't he responsible for the debts of the association?

MR. NETHERLAND: He is liable only to the extent of his stock, that is all. If the association fails, if the whole business breaks down, all he can possibly lose is his double assessment. He is no more responsible for the debts of the institution than the national bank stockholder would be, except to the extent of his double assessment. A national bank stockholder does not have to be liable for the deposits, but he is liable for his assessment.

MAJOR VIRGINIUS MEAD (Merchants & Planters Bank & Trust Company, Pine Bluff, Arkansas): Was that double assessment a part of the organization of the Farm Loan Act?

MR. NETHERLAND: Yes. Part of the original Act. It is either Section 19 or Section 25. Have you a copy of the original Act?

MAJOR MEAD: Not with me. I have one at the bank.

MR. NETHERLAND: You will find that it is either in Section 19 or somewhere along there.

A. GORDON PATTERSON (First National Bank, Pittsburgh): Do you find that the appraisals are made without political consideration, without any community interest, but on a strictly business basis of protecting the bondholders, or with the idea of getting as much money for the farmer as possible?

MR. NETHERLAND: The appraisals are unquestionably made by qualified men. They are not politically appointed. Our banks must recom-

mend the man who is to be appointed. I do not recall a single instance in our district where an appraiser appraises land in his own community. The appraisal system, gentlemen, has been reduced to a scientific proposition. I wish I had the time to go through some of those appraisal blanks with you. It takes from one month to three months to get a loan through. The reason for that is the necessity of getting a complete analysis. Our appraisal department is one of the most elaborate things you ever saw. And if you listened to some of these borrowers who are refused, you would realize it. We know exactly what a piece of land has produced under proper management in the last ten years. Some of these men in Chicago, because a piece of land is close to Chicago, say that they can get \$400 an acre for it, but all we want to know is what it will produce from an agricultural standpoint; if it will produce 6% on a valuation of \$50 an acre, that is all we will lend. We do not care if you can get \$5,000 an acre for it.

MR. PATTERSON: As I understand it, when the bonds were originally sold (I am talking from the standpoint of the bond buyer and holder) there was written in the Act this phrase: that the bonds were instrumentalities, that the Federal Land bank bonds were instrumentalities of the Federal Government. A great many bondholders believed that that was a guarantee on the part of the Federal Government. Prices of the Federal Land banks have not—I believe this is true—followed the prices of government securities. Some time ago I believe one of our western senators, Barr or Norris, recommended that the Federal Government

go into the open market and purchase a large number of Federal Land bank bonds in order to support the price of the bonds. Investors were having difficulty in disposing of them under necessity or under pressure at a fair value and the lower coupon bonds, taking into consideration the money market and all that sort of thing, are still below their original offering prices. In other words, why haven't Federal Land bank bonds kept the position that instrumentalities of the Federal Government should have? That is, why don't they sell on a parallel with government bonds?

MR. NETHERLAND: You remember that Federal Government bonds, liberty bonds, went to 85. Do you blame the Government for that? The Government has paid them at par when due and will continue to do so. Also, the Federal Land banks have kept their contract. They have paid their interest and will pay the bonds when due. If a man wants to take a market position on these bonds, that is his own affair. You cannot say that the Federal Land bank issued bad bonds because they went to 90.

As to their being instrumentalities of the Government, you know Porto Rico and Manila street paving bonds, and the sewer bonds of those islands are also instrumentalities of the United States Government, but the Government does not guarantee them.

The reason the bonds have not kept their position is because of just such statements as that by the men high in authority who voted for the Act. No one expects the United States Government to pay Philippine bonds in the event that they are not paid. Yet they are stamped on the face: "Instrumentalities of the United States Government."

Another thing about Federal Land bank bonds is that they are not as widely distributed as government bonds. Now when you get a rise of two or three points in a large issue of Federal Land bank bonds which are not put away like government bonds, you know yourself that they come on the market in pretty heavy volume.

Then I think the general condition of the farmer has something to do with that. We all know that the farmer has suffered terrifically and if an investigation is not made it is natural to assume that the Federal Land banks have had a great deal of trouble. The St. Louis bank owns three hundred farms in which it has invested a million and a half dollars. That seems like a great deal of land, but we have 34,000 loans. The percentage is less than one per cent. There is hardly a commercial institution in the country that is able to charge off its real estate at one per cent. All the farms it has had to take over have been charged off, and when the farms are sold, whether they bring twenty-five cents on the dollar or a hundred cents, it is able to put that back into profits. The total of all the banks is only six-tenths of one per cent. One of the large insurance companies carries fourteen per cent of its mortgage loans in real estate.

MR. PATTERSON: Part of the first question there I do not believe you have answered to my satisfaction. Is the stake of the local association to insure its cooperation in a fair appraisal and enforcement of collections?

MR. NETHERLAND: I think so. It is like this: If you are running a national bank and if when you make a loan, you have to indorse and become liable for it to the Federal Re-

serve, you try to make good loans. I think the local associations do the same thing. If I were the local stockholder or officer, I should do the same thing. They have an exaggerated opinion of values sometimes and we have to cut them down. That is their main difficulty.

The Federal Land banks have enough surplus and undivided profits to charge off all the land they have, all of the land they have got in foreclosure, without any impairment of capital stock.

FRANK M. PERLEY (American Security & Trust Company, Washington, D. C.): You said the margin could be spread in the Federal Land bank to one per cent. Do you know what it is in the Joint Stock?

MR. NETHERLAND: I do not know what it is in the Joint Stock. We are permitted in the Federals to charge a spread of one per cent. I think the law is the same for the Joint Stocks. But, as a matter of fact, we do not go that high. The law should read "one per cent of your average cost of money." Our average cost is as low as 4.505. Now, if we were to sell a 3½% bond issue, we should have to lend at 4% or 4½%. I think they ought to have a spread of a point and a half. There should be an agency to supervise that. The idea of the Federal is to lend money to the borrower at as low a cost as possible. The bank is not performing its function properly if it makes too much profit.

The Future of Municipal Financing

By FRANK C. NASON

MANAGER OF THE MUNICIPAL DIVISION OF THE CHICAGO TERRITORY,
BANCAMERICA-BLAIR CORPORATION, CHICAGO, ILLINOIS

Address before the Denver Departmental Conference

In the last decade municipal borrowing has increased very rapidly, and the questions arise: Are we going too fast? Will this ratio of increase continue? There is every reason to assume that it will.

For many years investment bankers have based their opinion of the soundness of municipal securities on the credit standing of the issuing community, the relation of the assessed valuation to bonded debt, and the opinion of a recognized bond attorney as to the legality of the issue.

Municipal dealers and investors are now demanding more complete information before investing. Good credit is, of course, essential. Another important factor in considering municipal obligations is the record of tax collections in a particular community. It is imperative that the banker and the investor know that all legal requirements have been complied with in the issuance of municipal obligations. The purpose for which bonds are issued, and the maturity, are other important factors in determining the market value of municipals.

Mr. Nason is confident that the future of municipal financing, representing the largest class of funded securities in this country, is indeed bright and promising.

IN the decade just ended, the obligations of states and municipalities in the United States, not including refunding issues or less than one-year notes, amounted to approximately \$12,000,000,000, while in the year 1929, with unfavorable bond market conditions prevailing at least three-quarters of the year, the volume was in excess of \$1,400,000,000. This total in 1929 comprised 30% of all funded obligations issued in the United States (government obligations excluded), which gives you an idea of the importance of municipal bond financing to the investment banker.

*The statistics and other information contained in this article have been taken from the Bond Buyer, The Financial and Commercial Chronicle, and other publications assumed to be reliable.

Let us look back even farther. In 1901, the first year that reliable figures were available, the obligations of states and municipalities were \$131,549,000, and for the nineteen years ending in 1919 the total was in excess of \$6,300,000,000. You will readily see that in the last decade municipal borrowing has increased very rapidly, and the questions arise: Are we going too fast? Will this ratio of increase continue? We ask these questions particularly in view of the trouble that has occurred in some sections of the country, and the inability of the issuing municipalities to meet their obligations. Let us consider why such a large amount of municipal bonds can be successfully marketed. Primarily, this is because the major

portion of such issues is backed by the full faith and credit of the issuing municipality and is payable from unlimited taxes. (We shall consider limited tax, special revenue and assessment bonds later.) Secondly, it is because these issues are exempt from all federal income taxes. Thirdly, it is due to the safety of principal and interest. Obligations of municipalities are one of the oldest forms of security and have proved to be one of the safest; the percentage of default in general tax obligations in the United States has been so small as to be almost negligible.

What has been done with the huge sums borrowed by municipalities in the past decade, exceeding \$12,000,000,000? The amount spent for state purposes is 15%; for county, 17%; for schools, 13%; the balance is used for city, town, parks, and so forth. The largest items have been for roads and schools.

THE FUTURE OF MUNICIPAL FINANCING

What of the future? May we expect as large a volume of municipal financing in the present decade as in the past? I believe that as long as this country continues to grow and develop we shall have plenty of municipal bond issues. The larger cities will require larger issues in proportion as population and areas increase. It is my belief that our road program has only started. True, we have seen the development of thousands of miles of hard roads in many sections of the country, but many of the states have not yet even started. We are living in an age of rapid transit, the gasoline age, if you please, and rapid transit requires good roads. Heavily

loaded trucks and busses are expected to average thirty to forty miles per hour, and are now transporting goods and passengers, we may say, from coast to coast, but as yet we have only primary or arterial highways, and the outlying sections not only require, but will demand, connecting highways. America is proud of her schools, and well may she be, but even so, our school requirements, on the whole, are far from adequate, and we may always expect a large amount of financing for buildings and equipment. School bond issues almost always have the hearty support of the voter. And so on down the list of various other municipal requirements. It is certain that a large volume of municipals will require financing.

Municipal financing is a highly specialized branch of investment banking. The average margin of profit to the dealer is probably smaller than on any other class of security, except United States obligations. There have been many changes in the past few years in the personnel of dealers handling this class of security, and there will be many more in the near future. The business is gradually getting into stronger hands. Large capital and countrywide distribution are essential to successful marketing, and large volume is necessary to show substantial profits.

For many years investment bankers have based their opinion of the soundness of municipal securities on the credit standing of the issuing community, the relation of the assessed valuation to bonded debt, and the opinion of a recognized bond attorney as to the legality of the issue. Municipal dealers and investors are now demanding more complete information before investing. Good credit is essen-

tial, with a record of having met all obligations of interest and principal without the slightest delay. Default even for a short time is a serious thing for a municipality and destroys its credit standing to such an extent that, even though all arrears are paid up, future bond issues are not looked upon favorably, and higher interest rates with lower prices for its obligations will result.

ASSESSED VALUATION

The bonded debt of a municipality is based upon its assessed valuation and is usually limited by law, either constitutional or statutory, but assessed valuation is a little known quantity, depending entirely upon the relation of assessed value to real value. When you consider that the assessed value in relation to the real value of property varies in the different states from as low as 25% all the way to 100%, I believe that you will agree that the real value, as determined by the assessors, is the proper basis on which to consider bonded debt. Boards of assessors are largely political and often are composed of men inexperienced in real estate values; this results in unequal assessments. Recently in some sections of the country recognized appraisal companies have been employed to determine the assessed values and have proved less expensive than political boards and more just to the property owner. I believe that this method will be extensively adopted in the near future. The relation of bonded debt to assessed value is likewise a very uncertain quantity, this varying from as low as 3% of the assessed value to an unlimited amount. The limit, in many states, is 5%, and careful investors

in municipal obligations are generally agreed that 10% is safe, provided the debt per capita is reasonable. Heretofore, bankers and investors have considered the debt of the issuing community by itself and have not taken into account the overlapping debts of other political subdivisions, coextensive with or including part of the same area. "Net debt" is the legal limit and does not necessarily include the actual debts payable from general taxes. Overlapping debt is the true debt of a community and is so considered by many large insurance companies and by several states in determining the status of bonds as legal for savings banks.

TAX COLLECTIONS

Another very important factor in considering municipal obligations is the record of tax collections in a particular community. I know of one large life insurance company that will not consider municipal bonds without a statement showing the record of tax collections during the preceding five years, and even though the relation of net debt to assessed value is a very small per cent, they will not invest if numerous tax defaults have occurred. This same insurance company considers the geographical location and the prevailing industry of a community, and refuses the obligations of a unit depending on one class of industry alone, unless that be diversified agriculture. I believe this procedure to be sound. We have seen too many illustrations of a boom town, rich today and broke tomorrow.

BOND LAWS

All municipal obligations are issued

in accordance with some law, either constitutional or statutory. We have altogether too many bond laws in this country. Very few states have constitutional bond laws; most of the states depend upon legislative acts to cover their bond issues. In the forty-eight states of the Union, it is safe to say that in no two are the bond laws exactly alike, although in many they are very similar. Investment bankers have done excellent work in the past in striving for more uniform bond laws and in preventing the passage of unsound measures, and I believe that this influence will be more welcome in the future, because the municipal authorities realize that the banker is their ally; for without his assistance in financing and marketing their securities, they would have scant possibility of realizing the proceeds of their bond issues.

It is imperative that the banker and investor know that all legal requirements have been complied with in the issuance of municipal obligations. This requires the opinion of a competent bond attorney, and a copy of his opinion is usually delivered with the bonds to the investor. It has too often been the custom for municipalities to offer their bonds for sale, subject to examination of the record and to the opinion of such an attorney, but I am glad to state that most of the larger communities are now having their proceedings supervised by competent bond attorneys and the legality approved before the bonds are offered for sale. This procedure has proved profitable to municipalities, preventing costly mistakes and delays, and dealers are willing to pay a better price for bonds that can be offered immediately for resale. To obtain a copy of the legal opinion on bonds

that have been outstanding several years and have come back into the market, is often very difficult and sometimes expensive, and I believe that some plan will be devised so that the legality of an issue may be incorporated either within or upon each and every bond. I have seen a very few bonds that had printed on the back "legality of this issue approved by, attorneys." Even this is a great help, as at least it tells what attorneys examined and approved the issue, but most investors insist upon the entire opinion, and I hope to see the former suggestion in effect some day, although I presume that the bond attorneys will oppose it.

PURPOSE OF ISSUE AND MATURITY

The purpose for which bonds are issued and the maturity are other important factors in determining the market value of municipals. Most general tax obligation bonds are issued for permanent improvements, but they should never be issued to mature after the average life or usefulness of such improvements. Many road issues have been issued to run forty years or even longer, far beyond the life of any road that has been constructed in the past decade; and some of our finest roads have been constructed in that period. This means that the road will be worn out and will have to be rebuilt before the bonds mature, and another bond issue will be loaded on the taxpayer. Occasionally bonds are issued for so-called municipal projects, such as memorials, which to my way of thinking should not be a burden to the taxpayer, but should be constructed from public subscription. Bonds for such

purposes meet with little favor from the investor, except perhaps locally.

The obligations of states as a class command the highest regard of the investor; next in line are the obligations of the larger cities and most prosperous counties. School bonds are always in good demand, particularly when issued by school districts coextensive with our principal cities. Serial maturities are more desired than issues of one maturity with sinking fund provisions. Sinking funds are elusive things, often having to be passed on through several administrations of municipal officials, and too often poorly administered.

DISTRICT BONDS NOT ATTRACTIVE

District bonds, except those of school, park, and sanitary districts, have not proved particularly attractive. The creation of districts for special and various purposes has been much abused. There have been many instances in which communities, not having sufficient bonding power to finance some particular proposition, have organized a special district to include some additional territory, thereby creating a municipal subdivision which can issue bonds to the legal limit of its assessed valuation, not, of course, taking into consideration the overlapping debt. Road districts have been especially numerous, and, we might say, notorious (referring particularly to the Texas situation of a few years ago). There have been too many districts, and we shall, I believe, have fewer in the years to come. Even road districts are, I believe, unnecessary, except in sparsely populated and isolated sections, and district bonds of that kind should be

a county or state proposition. In fact, I prophesy that all highways outside of incorporated towns and cities will some day be built and maintained by the state governments and the Federal Government. Many of the largest investors in municipal bonds are so opposed to district obligations that they will not consider the purchase of any except those noted—school, park, and sanitary. No reference is made here to special assessment districts, which are in a class by themselves; the bonds of these are not payable from general taxes, but by assessments against the benefited property.

SPECIAL REVENUE BONDS

There is another class of municipal obligations that is beginning to have serious attention from both dealers and investors, and that is special revenue bonds, such as water, electric light and power, and so forth. As a general rule, these bonds are not payable from general taxes but solely from the revenues of properties bonded. They are obligations of the issuing municipality and are exempt from all federal income taxes as well as from state and municipal taxes, where such exemptions prevail. These municipal properties are, or should be, self-supporting, and such bonds are deductible from the gross debt of a community in determining the net or legal debt. Unfortunately, but few of our states have adequate laws for the issuance of revenue bonds with proper protection to the bondholder; however, a number of states now have revised laws under consideration, and it can be confidently expected that this class of municipal obligation will prove to be very attractive investments. Already some of the large

insurance companies are including revenue bonds, when issued in certain states, in their portfolios, but I do not believe that eastern savings banks have let down the bars.

State supervision of municipal borrowing by commissions authorized to examine and advise local governing bodies in regard to proposed bond issues is a step forward and will prove to be of great economic value to the taxpayer. A few states already have such commissions and several others are seriously considering their establishment. Even though these commissions may not have the power to hold up a proposed bond issue, they will serve as a restraining influence, as it is well known that most voters are moved more by sentiment than by cold facts in approving a bond issue. I expect to see such commissions in most of our states in the near future and believe that fewer unsound and unnecessary bond issues will result.

MARKETABILITY OF MUNICIPAL BONDS

The marketability of municipal bonds has often been questioned by some people not familiar with this class of financing. It is true that many issues are not quoted daily, as are bonds listed on the principal exchanges, and that small issues often have but a limited market. However, it is my opinion that bonds of our states and principal cities are the real basis of bond values, reflecting the prevailing worth of money more accurately than any other class of security, except obligations of the Federal Government. We must also take into consideration the fact that municipal bonds are sold primarily for permanent investment, the majority of bonds

sold being held by the investor until maturity. Several times in past years, plans have been proposed for the establishment of a central market to stabilize municipal bond prices, but nothing has ever been done to carry out these plans, and I doubt much that anything ever will be done; neither do I see the necessity for such a move. Municipal bonds of well managed communities, in the minds of investors, represent the highest degree of safety, assuring the payment of principal with interest, and are considered the best form of investment in our economic system.

In conclusion, I wish to repeat that we shall have plenty of municipal bond issues. Bond laws are being improved, with the promise of more uniformity in the various states. Supervising commissions will regulate the soundness of issues, and the business of financing is getting into better and stronger hands, which promises more stability to prices and better markets for resales. The future of municipal financing, representing the largest class of funded securities in this country, is indeed bright and promising.

Discussion

WOOD NETHERLAND (St. Louis Federal Land Bank, St. Louis): Is the volume of indebtedness, what we call the public debt, increasing out of proportion to our national wealth? Somebody has to pay these road bonds; somebody has to pay these municipal bonds. But just how much are we mortgaging our future?

MR. NASON: Unfortunately in some sections of the country we have exceeded that proportion, but the average is well below. We are hav-

ing no particular difficulty in some sections of the country but are having a little distress in others because in the past eight or ten years these sections got a little too enthusiastic and issued too many bonds; now they are having some difficulty meeting the bond requirements. But the states are coming to their aid in the particular cases that I have in mind. I think generally we are well below our requirements.

A. GORDON PATTERSON (First National Bank, Pittsburgh): Mr. Nason, this is rather an academic question, but it follows Mr. Netherland's. I notice a very striking similarity between two of your statements. The income tax law is about twelve or thirteen years old. In the last twelve or thirteen years we have seen a great deal of municipal financing. I wonder if the tax-exempt feature does not give an unfair advantage in the money market. In other words, is not this reckless municipal financing helped unduly by that tax-exempt feature? Would it not be better for municipalities to finance themselves on the same basis as industrials or utilities; in other words, would it not be better for them to go to the money market without any special privileges?

MR. NASON: I think that is just what we are doing today. I do not think they have any special privileges. Of course, the federal income tax is an advantage. There is no question about that. But I will just take you back to 1902 and 1903 in the question of municipal bonds. There was no income tax then and you did not have any advantage over corporation bonds.

MR. NETHERLAND: You did so far as the regular property assessment was concerned.

MR. NASON: That depends on the state. There are not many states where municipal bonds are exempt from state and local taxation. They are not exempt in Illinois. But back in 1902, without any income tax, municipal bonds sold at far higher rates than they do today or have done in the last ten years. I think municipal bonds reflect the true bond values. I am going to be taken to task on that, but municipal bonds do sell nearest to money value.

MR. PATTERSON: Your statement that municipal bonds are selling at higher rates now than they did means that the yield is lower to the investor; he is going to take that lower yield because they are tax-exempt. The equivalent yield on taxable bonds puts them in an unfair position in competing with municipal bonds. We have a great many wealthy individuals who will buy only municipal bonds. That money might as well go into public financing and industrial financing. I think there has been, as you said, a good deal of reckless municipal financing; I wonder if it was not aided by that tax-exempt feature?

MR. NASON: There has been, and always will be, some reckless corporate financing. Let me amend my answer and say that back in 1902 municipal bonds sold at much lower yield than they sell at today and did not have the income tax exemption. It is a fact; you cannot get away from that. It is not so important as you think. The security is the big thing.

FOREST BURCHFIELD (Grand Rapids National Bank, Grand Rapids): This is possibly a little off the question, but you have not touched much on irrigation and drain-

age bonds. What is the future of them? Will they change any?

MR. NASON: I kept away from anything except general taxation obligation bonds. You can branch out without end. In regard to drainage and irrigation bonds, my opinion is that the future is not at all bright. It is very dark. Some of them are in default and that situation takes us right back to this marginal land proposition. The majority of those drainage districts never should have been drained. I have handled a good many drainage district bonds. I have investigated many of them. I

have never seen a drainage district yet in which there was not some big interest. That district was formed and organized primarily for this timber company or this land company to produce a market for that particular land. Drainage is very expensive, and nearly all these lands are not fit for cultivation after they are cleared. It is a very expensive proposition. When the poor farmer has gone in there and cleared it, he cannot afford to pay his assessments. Levees are very important in many sections of the country, but too many of those have been built, too.

The Investment Policy of Insurance Companies

By CLARENCE J. DALY

PRESIDENT OF THE CAPITOL LIFE INSURANCE COMPANY OF DENVER,
DENVER, COLORADO

Address before the Denver Departmental Conference

Insurance companies have always followed a non-speculative policy of investment, which, while it includes safety, conservatism, marketability, and yield, yet must afford in the form of returns from their investments, profits or yields which will tend to assist in the carrying of the somewhat uncertain risks assumed. It is a fact that by far the greater portion of profits made by these classes of companies, as a whole, over a period of years, has come from the investment branch of the business rather than from the underwriting branch.

The economic interests of the vast number of policyholders are paramount at all times. Owners of other forms of securities may protect their holdings from time to time, through purchases or sales, but life insurance policyholders may not.

The investment policy of the institution of life insurance has been, and will continue to be, conservative, safe, non-speculative, and stabilizing as to the public interest.

IN undertaking a discussion of this subject it must be borne in mind that the general term "insurance companies" includes:

1. The institutions and associations engaged in fire insurance and collateral lines, including so-called marine insurance

2. The institutions and associations known as casualty companies, which issue all forms of liability, compensation, plate glass, accident insurance, and so forth

3. The institutions and associations known as surety companies, undertaking for the most part the furnishing of bonds of all kinds and descriptions

4. Finally, those companies constituting the institution of life insurance.

Any attempt on my part to discuss, describe, or prescribe an invest-

ment policy for all these different classes of companies must be extremely general. With so many kinds of insurance companies, with such vastly different risks assumed, and with such discrepancies in the plans and procedures of underwriting, there would be required a financial genius indeed to bring home a really constructive, conclusive exposition, or even a suggestion of great merit.

Each and every one of us does well to follow and carry out the counsel, advice, and orders of his bankers, and my appearance here is pursuant to positive orders from my bankers. At their request, I shall attempt in this talk to deal to some extent with a problem which probably should be handled by at least two speakers, and to point out differences or variations

between the policies of the several classes of insurance companies.

It is perfectly true that there are certain requirements and qualifications of investment policies which apply to all insurance companies irrespective of the class of company involved. Some of these are safety, yield, marketability, and diversification. But the nature and characteristics of the different forms of insurance, with the too numerous, comparatively certain, and comparatively uncertain risks involved, require that the particular class of insurance company have an investment policy which shall seek those investments best fitted to the specific and peculiar hazards of that particular institution's activities.

PROFITS COME FROM INVESTMENT BRANCH

I am rather of the opinion that for the purpose of argument, at least, it would not be too far wide of the mark to say that fire, casualty, and surety companies present considerable similarity in the specifications that fit their investment policies; that is to say, the investment requirements of these three classes of companies are not wholly unlike. These companies engage in branches of the business which involve considerable uncertainty. The risks that they assume cannot be ascertained nor calculated with any great degree of certainty. Their contracts are for the most part short time contracts. Their policies are cancelable. These classes of companies, because of these conditions and because of the uncertainty of the risks assumed, must of necessity adopt and follow an investment policy which, while it includes safety, conservatism, marketability, and yield,

yet must endeavor to afford in the form of returns from their investments, profits or yields which will tend to assist in the carrying of the somewhat uncertain risks assumed. It is a fact that by far the greater portion of profits made by these classes of companies as a whole over a period of years, has come from the investment branch of the business, rather than from the underwriting branch. Such being the case (and I believe that the records will prove it to be so), there is positive and indisputable evidence that the investment policies of such companies include, in addition to safety, yield, marketability, and diversification, a substantial holding of sound assets, from which a reasonable return may be expected, plus a more than likely probability of some extra return, enabling the investment branch of the business to make a profit in and of itself, and, in addition, to assist in carrying the burden of probably small or diminished profits in the underwriting branch.

Theoretically, the underwriting department should make a profit independently of the investment department. During certain times and under certain conditions, such has been the case. Certainly, however, this is not always true, and such underwriting profits as have been realized have been extremely small, with frequent instances of absolute loss. The investment department of a large number of companies has been carrying the load.

CONSEQUENT IMPORTANCE OF INVESTMENT POLICY

With inadequate returns from underwriting departments, and substantial dependency for profit and prog-

ress upon the investment departments, it seems essential that the investment policy should, subject to the requirements of the insurance investment laws of the different states in which the companies are operating, give due and proper attention to safety, yield, marketability, and diversification, but must include the far seeing and wise selection of investments from which the necessary earnings may be had to bring about the required returns.

Unquestionably, if insurance companies of these classes are a success, and are to continue to succeed, underwriting executives of the best ability must be obtained, maintained, and retained, in the interest of bringing as much profit as is possible to the underwriting department. And certainly, in view of the situation above referred to, where investment departments have been carrying a big part of the burden of the load, it is equally important that an extremely well organized and competent executive investment department shall function freely, confidently, and intelligently. Reliable analytical and research facilities must be available and must be used continuously. It may be properly stated that the most thoroughly organized underwriting department in existence will not permit of any marked success for the company without an investment department capable of directing the income of the company in such a way as to assure at least an average increase and appreciation of assets.

NEED FOR RESOURCEFULNESS, ANALYSIS, AND VISION

It is not my purpose to attempt at this time to prescribe investment port-

folios for companies which may contain a preponderance of bonds, common stocks, preferred stocks, or mortgages; nor do I feel competent by any means to undertake a suggestion as to ways and means of improvement of that which has already been done by the most able management in the country. We find among our most successful companies in these classes many where the bulk of the invested assets is in bonds, which include government, state, municipal, industrial, and utility issues. We find some where a substantial portion of invested assets is in mortgage loans. Some companies have heavy investments in preferred stocks, and some, even, in common stocks. Successful companies can be found where the bond investment predominates, and some equally successful where mortgage loans predominate. It does not seem to be a question of which one of these investments predominates, but rather of how wisely they are selected and held. If any formula at all were to be prescribed, I believe it would be as follows: the first essential is the maintaining of an organization which is resourceful, analytical, and far sighted enough to adapt itself to the ramifications of the business of its particular company, and intelligently to select investments calculated to fit into those particular ramifications. It should exercise care at all times to keep free from purely speculative investments, and should balance the diversification of the different classes of investments purchased, so that the ups and downs of normal business progress may not too heavily nor too seriously affect the status of the particular company, and yet may provide adequately diversified holdings to permit of enjoyment of suffi-

cient prosperity in the case of certain investments, to offset reasonably the temporary lack of prosperity in certain other classes of holdings.

To give an idea of the increase and appreciation of the invested assets of some of these types of companies, it is stated that in the year 1929 the percentage varied from an increase of 7.17% to a decrease of minus 25.68%. While it is true that 1929 presented conditions which were unusual, yet, tracing these same companies back over a period of years, we find emphatically demonstrated that the unencumbered, free-working, well organized, and competent investment departments of many of these companies have shown business profits over a period of approximately twenty-five years, in amounts substantially over and above the requirements of the underwriting department, plus a good return for the investment department. Since we have laws in the various states to define and prescribe in at least a general way the forms of investments in which these companies may invest, and since these laws for the most part take into account reasonable safety, yield, marketability, and diversification, the best investment policy of these companies is that policy which includes the demands and requirements of the history and experience of the business. The best insurance that can be had, guaranteeing such a policy, is a smooth-working, unemotional, analytical investment department, which, of course, means the very best and soundest of talent obtainable.

FACTS PERTAINING TO INSURANCE COMPANIES

Before entering into a discussion

now of the investment policy of the institution of life insurance, it may be of interest to relate a few outstanding facts pertaining to its activities and characteristics.

At the close of the year 1929 there was in force in the United States in excess of 70% of all the life insurance in the world, amounting to more than \$100,000,000,000, on the lives of more than half the population of the United States, numbering over 67,000,000 policyholders, in 20,000,000 homes, and backed by assets in the amount of \$17,000,000,000, the latter figure having doubled within the last eight years. Since 1900 there has been \$20,000,000,000 paid to beneficiaries and policyholders, in the form of benefits, and the per capita insurance in this country has been increased from \$111 to \$850. In 1929 there was \$19,800,000 of new life insurance sold, and \$2,000,000,000 was paid to policyholders and beneficiaries.

ECONOMIC INTEREST OF POLICYHOLDERS PARAMOUNT

The economic interests of the vast number of policyholders are paramount at all times. Owners of other forms of securities may protect their holdings from time to time, through purchases or sales, but life insurance policyholders may not. Their funds for the most part remain with the insurance companies for investment. The faith and confidence of the public in the institution of life insurance probably exceeds its faith and confidence in any other institution, mainly because of the record of the insurance companies (not a loss to a legal reserve policyholder), the legal reserve system which is behind the pol-

icy contracts, the efficiency and consistency of the management, and the successful survival through periods of depression and stress, together with the supervision exercised over this institution, and the legislative reforms from time to time enacted for the greater safety of the interests of the policyholder.

Through the operation of the legal reserve system, whereby a portion of each year's premium is set aside to take care of the mortality indicated and demonstrated by the mortality tables, the reserves so set aside, plus the accumulation of interest or earnings on these reserves, provide the necessary funds to take care of the losses as they occur. In case the number of policyholders is considerable, sufficient to bring about a fair average, the funds representing the reserves and accumulations will be more than adequate.

SPECULATIVE INVESTMENTS OUT OF PLACE

Low rates of interest only are required under the reserve laws, and with such low rates required, only the highest type of investments may properly be acquired. Speculative investments, or investments contemplating speculative profits, are out of place in this system, but income varying from 3% to 4% is essential to enable the reserves to carry out the purposes for which they were set aside. Under these conditions, and because of the nature of the business, the factor of safety in investments of life insurance is more vital than in investments of any other form of insurance. Investments of a stable character, not subject to violent fluctuations, are, and must be; selected. While there may

be a slight element of speculation in any project or enterprise, there is no definite or appreciable factor of speculation in those investments chosen. The obligations of the policy contracts of the life insurance companies for the most part mature a considerable number of years in the future, and this characteristic must be taken into account in whatever selection is made. While the best of care and judgment may be exercised as to the investment of these funds, a selection that does not take carefully into account the comparatively distant maturity of the policy contracts is somewhat speculative, and may fail in the accomplishment of that which is essential for the carrying out of the obligations of the policy contracts.

The function of the investment of policyholders' funds in life insurance companies amounts to a trusteeship. These funds are held in trust and invested, ultimately to be paid to the policyholders and their beneficiaries. In the investment of them, the life insurance companies are bound by this trust to exercise at all times the maximum of good faith and the highest degree of care. The various states of this country have from time to time enacted laws with reference to the investment of life insurance funds. There is no absolute uniformity. Some states are more severe than others, but in the main the intent of the laws is to prescribe for the investment of life insurance funds a safe, non-speculative, conservative policy, which centers principally in certain well known types, such as (1) government, state, county, railroad, public utility, and Federal Farm Loan bank bonds; (2) real estate mortgages, both farm and city; (3) policy loans to policyholders, secured by the

reserves on their policies; (4) real estate acquired through foreclosure or for home office purposes. These types are more or less standard, and provide safety with moderate income.

Other forms of investment, such as stocks of other insurance companies, utilities, banks, railroads, and even bankers' acceptances and bills of exchange, may be within the bounds of safety, but do not contain the elements necessary to so great a degree as do the forms and types of investment just previously enumerated.

Still another class of security to be mentioned is the industrial corporate bond. Under proper conditions this may be extremely safe, but, if selected, it must be carefully analyzed and tested.

Yet another form, the common stock of industrial enterprises, is now permitted in a number of states, and there are so many factors to be taken into account in reference to the selection of these, that it would seem that restrictions as to the amount of holdings in this class should be enforced by those states which permit their acquisition, and that, independently of the fact that they are permitted, they should be acquired most sparingly, if at all, and only after exhaustive consideration as to their equity status, as well as the realization of the fluctuations up and down, so often characteristic. For my part, guided by my comparatively limited experience, I should rather see the life insurance companies maintain in their investment policy the relationship of creditor than that of partner. There is a wide difference of opinion on this subject, and many authorities have expressed themselves emphatically. The records and accomplishments of the institution of life insur-

ance are such, and the confidence in, and power of, the activities of this institution are so marked, that any substantial change in its investment policy may be made only when essential or mandatory, from the point of view of the interests of the policyholders, rather than from that of the stockholders.

INVESTMENTS OF LIFE INSURANCE COMPANIES

Thus far the investments of life insurance companies have unquestionably taken into account the public interest, and by so doing have played a most useful and beneficial part in the affairs of the country, concurrently with their own operations. Tracing back over a comparatively short period, to a time when these United States were being developed and opened up to traffic and trade, about one-third of the assets of all companies were invested in railroad securities. More recently, when the transportation facilities had been coordinated and developed intensively, life insurance companies played a tremendous part in taking up United States Government bonds, through the period of the war, increasing their holdings in these securities from a very small fraction of a percentage to more than one-tenth of their assets. Still more recently, as the pressing need for so substantial a participation in these securities was not evident, the percentage held by the companies diminished, and the funds were directed to channels which had to do with the remarkable development of the building expansion program of our cities. This particular investment is in the form of mortgages, both city and country, which mortgages comprise

40% of the assets of all companies in the country. Then, too, the development of the cities and towns, and the tremendous building programs carried out, have increased the activities and facilities of the great utility companies of the country, and holdings of insurance companies in this type of investment have increased from 3% of all holdings in 1921 to 9% at the end of 1929.

Policyholders in the life insurance companies have themselves benefited materially through the more than \$2,000,000,000 in policy loans obtained by them from their companies.

THE INVESTMENT POLICY OF INSURANCE COMPANIES

In conjunction with the building of roads, schools, bridges, and other state, county, and municipal improvements, an outlet for the obligations necessary to bring about these improvements has been furnished in a substantial way through a heavy and general participation by the life insurance companies in the bonds issued for such purposes. Even in the matter of guaranteed or preferred stocks, the holdings of the companies have increased from over \$20,000,000 in 1928 to over \$200,000,000 in 1929. Today an analysis of investments of companies representing over 90% of the insurance in force shows: mortgages, both farm and city, over 40%; United States Government bonds, over 8%; bonds and stocks, about 37%; policy loans, 13%; and real estate, 2%. The investment policy of the institution of life insurance has been, and will continue to be, conservative, safe, non-speculative, and stabilizing, as to the public interest. The institution has endured

and prospered through panics, wars, and epidemics. If there was the slightest question or doubt as to its soundness and stability, its immovable and invulnerable position through the stock market collapse of last fall furnished ample proof and conclusive evidence. The extent of this collapse was greater in dollars than all the assets of all the life insurance companies of this country. Individuals and institutions suffered greatly. A serious setback in our affairs took place. Business in general rode through the storm, however, because of the remarkably prosperous condition of the country's affairs. The institution of life insurance maintained its position through it all, practically unchanged, and free from anxiety. The operations of its business did not vary from normal. All claims and benefits were paid in full. And the investments and holdings representing the assets of the companies continued to furnish the returns and yields, maintaining and preserving the reserves and surplus funds as heretofore.

An institution of so tremendous a magnitude, which can, without fluctuation or variation, maintain its position so strongly, so irrevocably, not only in normal times but through stresses, depressions, and upsets, undoubtedly is an institution whose investment policy is in the interests of the public, and for the interests of its policyholders. A continuance of the same investment policy, without substantial deviation or appreciable modification, will perpetuate the faith and confidence in the institution, permit of a continuance of capital participation in the public interests, and assure the full and prompt return to policyholders of their dollars, held by this institution in trust for them.

Farm Loans

By A. C. TOSCH

ASSISTANT SECRETARY OF THE CONTINENTAL ILLINOIS BANK AND TRUST
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Address before the Denver Departmental Conference

The financing of homes and farms is fundamentally sound. Farming is a basic industry, and we must continue to finance it; but, in arriving at amounts to loan, more consideration must be given to the proper determination of value.

Individual real estate loans, both farm and city, have a place in every well selected, conservative list of investments. Today, as never before, a well placed, properly made individual real estate mortgage loan is one of the most desirable forms of investment; but, if we hope to retain the confidence of investors in this class of security, due care must be exercised in the making of loans, in order to keep losses down to a minimum, and service must be rendered on those loans during their life.

We should extend to our investors the service to which they are rightfully entitled during the life of the loan, making proper application of commissions, so that each year we shall have an income for the services which we perform.

BECAUSE of the necessity of the home and the farm, they have long been looked upon by the prudent investor as among the most essential and desirable projects to finance. It is a type of investment with which many investors are familiar, as they have perhaps been in the position of borrower in the acquisition of their homes or farms. When they acquire additional wealth and seek a place for the investment of funds, accordingly, they naturally turn to this form because of their knowledge of and confidence in it. Only in few instances today do the borrower and lender deal direct, and mortgage financing has become one of the most important and specialized phases of investment banking.

During the past ten years farm loans, and during the past two years a certain class of city loans, and par-

ticularly large mortgage bond issues, have caused considerable difficulty to both the mortgage banker and the investor, with the result that some of the investors who have long considered this one of the most desirable types of investment are beginning to doubt the soundness thereof and have become hesitant in purchasing this class of security.

REASONS FOR PRESENT FEELING OF UNCERTAINTY

Whereas experience over a long number of years has amply demonstrated that real estate mortgages are a sound investment, we cannot lose sight of the fact that recent experience in this field has caused a feeling of hesitancy on the part of old time mortgage investors. Unquestionably, this feeling of uncertainty has resulted

from mistaken policies with respect to the proper appraisal of real estate security. I believe it is true that we can in a large measure attribute losses which may have resulted from real estate mortgage loans to the failure of the lender properly to appraise the value of the security and to loan the proper percentage thereof. He has been misled by abnormal conditions and demands, and his loans have been based on sale value of properties and cost of construction, rather than on the proper basis of a conservative capitalization of income.

Prior to the deflation of land values which started in 1919, the demand for land and sales within a community was the basis for the determination of values in that community. During the period of the war the farmer had been urged to maximum production. He received exceptional prices for his products, and, naturally, with the increased wealth, he purchased more lands. Then, as the demand for land increased, the prices continued upward; but as the nations once again resumed peace-time operations and began producing their own food supply, the American farmer's increased products could not be absorbed entirely within this country. The price of farm products being once again determined by world supply, the farmer today in many instances finds that his income is insufficient to take care of taxes and interest on his mortgage indebtedness, not to mention any return for himself on the capital investment he may have therein.

DETERMINATION OF VALUE

Farming is a basic industry, and we must continue to finance it properly; but in arriving at amounts to

loan, more consideration must be given to the proper determination of value. Values must be based on productivity of the land, with due consideration to normal prices for products. We have learned the same lesson with respect to larger city mortgages: normal operations, obsolescence, and other important considerations affecting the actual operation of properties, have received too little consideration.

With the individual home it is perhaps a little different, as the borrower's income is more or less fixed, and he can determine for himself the proportionate share which he can allot, and that in a measure will determine the kind of property which he can maintain. His desire to own his own home and the ability to set a fixed amount which he can use for that purpose enables him to pay the mortgage.

Today, as never before, a well placed, properly made individual real estate mortgage loan is one of the most desirable forms of investment; but, if we hope to retain the confidence of investors in this class of security, due care must be exercised in the making of loans in order to keep losses down to a minimum, and service must be rendered on those loans during their life.

We should confine loaning operations to our own locality, as we are more familiar with land values, costs of construction, demands, and type of construction best adapted for this particular locality. In arriving at valuations, we must be governed by the income to be derived over a normal period and let the costs of construction and present sale values caused by extraordinary demands for property be secondary.

SERVICE TO INVESTORS

We should extend to our investors the service to which they are rightfully entitled during the life of the loan, making proper application of commissions, so that each year we shall have an income for the services which we perform. It is our duty to see that the interest and principal are collected as they become due, taxes searched annually, proper amount of insurance kept in force, and, in a measure, a market maintained for the security. The practice of advancing interest should be avoided, but, if such is the policy, due notice of each advancement should be given the investor. If taxes become delinquent, the investor should be notified, so that he may purchase the tax certificate and protect his lien. If insurance expires, proper renewal policies must be procured.

A market should be maintained for securities, as there are times when it becomes absolutely necessary for the investor to realize on his security. You should not be expected to stand ready to relieve an investor at any fixed price, regardless of rates and conditions, and no arrangement to repurchase at any time on a fixed charge should be agreed upon.

When the principal matures, it is your duty to make every effort to collect it, unless renewal is desirable. If foreclosure becomes necessary, handle the matter for the investor, the actual cost being borne by him, until you acquire title for your investor, and if he then desires that you continue to manage the property, he should also expect to pay for this service. The average investor realizes that, regardless of what care may have been exercised in the making of loans, there

is always the possibility of its being necessary to take over the property to satisfy the debt, and if, when selling investments, matters are thoroughly explained to your investor, you should not be requested to relieve him of the property should it be acquired. Too often the mortgage banker's unwillingness to admit error in judgment or fear of losing an investor prompts him to take over the property when trouble develops.

COMMISSION TO COVER SERVICES

For the services which we perform in the making, selling, and servicing of loans, the commission must be sufficient to cover these costs and a profit. Eagerness to get business so as to satisfy the demands of investors and borrowers often prompts us to make loans on which the commission is insufficient to cover the costs and a profit, but in such instances there should be a minimum charge, or the investor must expect to take the loans on a lower basis so as to enable us to make a profit. The average individual investor expects a 6% rate on a real estate mortgage investment, but if he is to get the highest grade of security he must expect no greater return thereon that he can get on other high grade securities, or a rate which insurance companies and larger investors are willing to accept on first class real estate loans.

Individual real estate mortgage loans, both farm and city, have a place in every well selected, conservative list of investments. The period for which they are made, usually five years, makes them desirable in that the investor can take advantage of rates at various times, and, should it become necessary to dispose of his

security, he can dispose of it at a reasonable discount because of the stability of rate in this class of investment and the comparatively short period it has to run. During the high rate period in 1921 and 1922, when every security, including our own government bonds, was selling on a basis to yield as high as 7%, investors in real estate mortgages who found it necessary to dispose of their securities were able to do so and accept a lower discount than on any other security.

In this class of loans, should trouble develop, the investor can act at once without consulting the wishes of others, as in the mortgage bond issues. He can convert the security once acquired to his own use, or, because of the constant demand by individuals for homes, if his loan has been properly made, he will experience little trouble in disposing of it at a price which will repay the principal, accrued interest, and costs which he may have invested therein.

FINANCING OF HOMES AND FARMS FUNDAMENTALLY SOUND

In practically every state in this Union we are now experiencing a slump in real estate, due to overconstruction, unemployment, and various other factors. The financing of homes and farms is fundamentally sound, however, and there is no cause for alarm on the part of the smaller investors, as the insurance companies and larger investors have confidence and are willing to finance these projects on a proper basis. If due care is exercised in the granting of loans so that the owner may have as much interest in the security as the lender, and if we will consider carefully the moral risk of the borrower and his ability to pay, and will finance only the proper kind and type of construction, the individual investor will again regain confidence, and will hold this class of investment in high esteem, as formerly.

City Loans

By IVAN D. CARSON

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Address before the Denver Departmental Conference

Real estate financing is no mushroom growth; its roots extend deep down into the land, which is the basis of all wealth; and it has been in existence for uncounted centuries.

But the modern real estate bond is "comparatively a child in the family of investment mediums. Large real estate bond issues distributed generally to the public were practically unknown ten years ago."

Mr. Carson divides the consideration of real estate bonds into three parts: underwriting; the care of troublesome situations; and distribution.

BY agreement Mr. Tosch and I have made a further division in the general subject of real estate mortgages. Mr. Tosch has taken the subject of the individual mortgage, emphasizing farm mortgages, and I have taken the subject of city real estate loans, and will confine myself to a brief consideration of what I deem to be certain important considerations with respect to the larger city real estate loans which are floated in the form of real estate bond issues.

As an introduction to a general discussion of real estate bonds, I wish to touch briefly on two phases of the subject which I believe are often overlooked, particularly where real estate bonds are adversely criticized, as they very often are in some circles.

The first of these introductory considerations has to do with certain factors of economic importance and inherent stability in improved real estate as security for mortgage bond issues.

We need only repeat the old axiom that land is the basis of all wealth to bring home the fact that the eco-

nomic importance of improved real estate is unquestioned. It is perfectly obvious that we need homes to live in; apartments to meet the needs of city dwellers in crowded areas; office buildings and stores in which to conduct our business; and factory buildings in which to produce goods.

THE ECONOMIC IMPORTANCE OF THE SECURITY

All classes of financing must be judged from the economic importance of the security. Types of business and industry which fall into the class of necessities, all things being equal, have in them certain inherent qualities that make for investment stability. Starting from this point we see clearly that real estate financing has a background of economic importance that is basically sound. Whereas these and like considerations with respect to a given class of security do not act as guarantees against mistaken judgment or poor underwriting methods, they do clearly demonstrate, when applied to real estate, that real estate financing

is basic in its economic importance, here to stay, and worthy of our most serious study and consideration.

THE CONSTRUCTION INDUSTRY

This brings us to the second general introductory consideration, namely, the importance of the construction industry, which is financed largely by mortgage money. The rate of construction activity has certain very definite barometric values. Business forecasters watch the building figures closely, and building contracts awarded are used as one of the important indices determining the future trend of business activity. This is only natural, because for the past ten years building construction in this country has absorbed on an average approximately \$5,000,000,000 annually. It provides employment for a large percentage of our people. Sharp upward or downward movements in the building curve have a tremendous effect upon business generally. A sustained trend of healthy construction activity makes for prosperity. As a matter of fact, building affects practically every basic industry in our national economic fabric. The sags in the building curve, therefore, are very costly to business as a whole, and this constitutes another compelling reason why the financing of building activities merits the serious study of our best financial minds to insure an even trend, and to make it possible always for legitimate building activities to be properly financed in keeping with the type of security which they constitute.

As further background material I should like to discuss briefly what has happened in building since the war. Certain statistical information should

be considered before one can obtain a true conception of the present status of real estate bonds generally, or of the possibilities of the future in the field of real estate financing.

STATISTICS OF THE BUILDING INDUSTRY

The period from 1919 to 1925 was one of great expansion in the building industry. This is brought out by a study of per capita building expenditures for the period. The per capita expenditures for building construction, excluding engineering construction, for the period were as follows:

1919	\$30.91
1920	31.54
1921	30.83
1922	44.75
1923	50.27
1924	53.92
1925	65.77

Increased costs should be taken into consideration; yet the increases noted in the period certainly are more than sufficient to indicate a time of tremendous expansion.

From 1925 to 1928 the per capita expenditures for construction, excluding engineering construction, have been below the 1925 level; for 1926 the figure was \$64.28; for 1927, \$59.86; for 1928, \$60.60; and for 1929, approximately \$52.12. The total volume of building, excluding engineering construction, for the period 1924 to 1928 averaged, according to F. W. Dodge Corporation estimates, \$5,000,000,000. For 1929 the total amounted to \$4,505,948,500.

Since 1925, engineering construction has kept the total volume of construction close to the 1925 volume of

total construction. In 1925 the per capita expenditure for all kinds of construction amounted to \$74.39; in 1926, to \$74.78; in 1927, to \$71.30; in 1928, to \$72.56; and in 1929 there was a decline to approximately \$63.13.

An analysis of these statistics indicates clearly that the year 1925 terminated a period of great expansion in building activity. Residential building reached its peak in that year. Thomas S. Holden, Vice President in charge of the Statistical Division of the F. W. Dodge Corporation, has said, with respect to the building activities of the period, that speculative building reached its crest in 1925; "easy money conditions still prevailed; in some respects the country was overbuilt at that time."

Building activities must be financed; consequently mortgage financing increased at a very rapid rate, principally the issuance of real estate bonds to finance apartment, commercial, and hotel projects.

With this background prepared, we can now turn to a consideration of what has taken place in the field of real estate financing through the flotation of bond issues.

For the sake of convenience I wish to divide the general consideration of real estate bonds into at least three major divisions: first, underwriting; second, a brief discussion of plans for taking care of troublesome situations; and, third, the distribution of real estate bonds.

It is obvious from the statistics just referred to that we have just passed through a great building boom in this country. The boom was national in scope and contributed in no small way to the prosperity we hear so much about in these times when business

conditions are not roaring along so tumultuously on the upper side of the curve. During the period from 1921 to 1928, the total of real estate bond issues mounted annually to unprecedented heights. In fact, it was during this period that real estate bonds came to be considered as something to be reckoned with in the underwriting and distribution of investment securities. Although real estate financing is as old as man, the real estate bond, as it is known today, is comparatively a child in the family of investment mediums. Large real estate bond issues distributed generally to the public were practically unknown ten years ago.

UNDERWRITING

When we turn our attention to the underwriting of real estate bond issues, we must keep in mind the fact that real estate mortgages have always enjoyed a record second to none and have occupied first place in the consideration of the investor. The extreme safety of a well chosen first mortgage has long been part and parcel of our investment thinking. It is perhaps true that too much of this feeling has been carried over into the field of real estate bond financing, with the result that, coupled with the crying needs for new construction which characterized the post-war period, this feeling of inherent safety to be found in all first mortgages may have caused both underwriter and investor to become somewhat careless. This I believe to be only natural. In other words, there is an element of speculation attached to every new business project, and it is perhaps true that the speculative element was somewhat overlooked in the real estate

bond field, both in the manner of underwriting and in the distribution of real estate bonds. The needs of the time were so great that bond houses and banks alike may be said to have carried over, into a new era of real estate financing, the old methods and ideas which had been practised in this field for generations. Certain new developments came about, of course, but inherently the principles back of the mortgage financing of yesterday were carried over into the field of larger real estate financing, minus certain changes or adaptations which experience seems to show would have been beneficial.

In the first place, conditions prevailing today indicate that more of the principles applied in the underwriting of general corporate securities might well be applied in the underwriting of real estate bond issues. We should, therefore, start from the point that there is no magic power in real estate securities and first mortgages generally. It is just as true in the real estate field as in any other that the only safe thing to rely on to meet bond requirements, interest, and principal payments, is earnings. Percentage of valuation is important, will always be extremely important, but in the final analysis it is income that counts. I do not mean to give the impression that percentage of valuation should be overlooked or discounted; what I do mean is that a proposed security for a real estate bond issue should be studied from top to bottom to determine what its income possibilities really are. The actual operation of other properties similar in character should be studied over a period of years, if this is possible, in order to determine with a high degree of accuracy what the long trend earnings

of the project in question will be. Fixed percentages of occupancy or vacancy are not in themselves sufficient to enable the underwriter to arrive at a clear understanding of what the earning possibilities of a given property will be. When an underwriting is contemplated, we must remember that we have to live with that issue ten or fifteen years or longer.

THE SINKING FUND

Experience of the past few years in the real estate bond field would indicate, also, that a wider use should be made of the sinking fund principle. Serial maturities have always been traditional in the field of real estate finance. While it is true that the best way to pay a debt is actually to pay it, nevertheless well set up and carefully administered sinking funds serve to keep issues in good condition during times of stress. In prosperous times the sinking fund principle provides for a flow of surplus earnings to reserves to be used to buy bonds, or to serve as a fund to be used for retirement of bonds at maturity. The sinking fund principle undoubtedly works to the advantage of the corporation, and, all other things being equal, whatever is beneficial to the corporation will, in turn, prove beneficial to the holders of its securities. Many intrinsically sound issues have gone into default because conditions that are temporary have made it impossible to meet heavy serial maturities. At best, foreclosure is an irksome, expensive matter. Whereas the right of foreclosure, plus heavy serial maturities, lends itself beautifully to sales purposes, in actual practice the picture is not quite so attractive.

In every discussion of corporate se-

curities—in fact, whenever business is considered—management is a subject of major importance. It has been amply demonstrated that capable management of a business is one of the factors essential to satisfactory experience with the company's securities. Let me emphasize that capable and experienced management is essential to the successful operation of real estate properties, apartment buildings, hotels, and office and commercial buildings. This is particularly true in a highly competitive area. The management of real estate properties has come to be a highly specialized business in itself. All other things being equal, the securities of a corporation experienced in the management of properties are to be preferred from the underwriter's point of view to others where the management feature is not so attractive. Experience has proved definitely that the underwriter of real estate securities will do well to place considerable emphasis upon management, for management in the real estate field will become increasingly important, as is the case in other lines of business.

APPRAISALS

It is the purpose of this talk to consider certain broad principles with respect to real estate securities rather than specific subjects such as methods of appraisal, arriving at costs of construction, and like subjects. We will pass such subjects by, interesting as they are, with this one brief comment on appraisals. The appraising of property for real estate bond issues should orient itself primarily from the consideration of income and income possibilities over a period of years. Actual utility in operation of land and

improvements must receive primary consideration rather than present-day sales prices, and like bases for valuation, which necessarily must be more or less haphazard. Changing neighborhoods and residential or business movements to or from a given location are some of the important factors which must enter into the appraiser's estimate of property valuations, because it is the income possibilities of a given piece of improved property over the period of years of the bond issue that counts. If the income is good, foreclosure or liquidating values will take care of themselves, and refinancing will not be a serious problem. Generally speaking, if the income is in proper proportion to the size of the issue and to the bond requirements, your valuation will be right.

REAL ESTATE BONDS MUST STAND ON THEIR OWN FEET

This brings us to the final principle we wish to discuss with respect to the underwriting of real estate bond issues; namely, that it would be well for all underwriters of real estate bonds to adopt the principle that real estate bonds should stand on their own as all other classes of bonds are made to do. It is felt that a general acceptance of this principle would do much to clear up the present situation and go a long way toward serving as a safeguard for the future. The knowledge that each issue is to stand definitely on its own legs and will not be supported or kept in good standing by the advancement of funds to meet interest and principal payments when these funds are not forthcoming from the borrower, will insure greater care in underwriting, and, in

the long run, will be more reassuring to the investor. Keen competition, plus a heritage of the past, which led banks and bond houses to take over mortgages from their customers and work them out, has been responsible for the adoption of this policy, which has been generally practised in the real estate bond field. It is purely an artificial means for keeping issues in good standing and has brought with it a sense of false security which has not been good for the underwriter or for the investor. As a matter of fact, the investor has no right to expect 100% safety, and an artificial stimulus of the type that has been so prevalent in the distribution of real estate bonds and mortgages has not proved to be a constructive force. It is felt that courageous leadership, in bringing the investor to see the wisdom of this principle, is perhaps the most constructive force in the field of real estate finance today.

With this discussion of a few general underwriting principles of fundamental importance, I wish to turn for a few minutes to a consideration of trouble in the field of real estate bond issues.

TROUBLESOME SITUATIONS

We must not overlook the fact that trouble comes to all classes of securities. I know of no class of securities that has not had its share of trouble. Real estate is now coming in for its share, because of a combination of reasons, which include overbuilt conditions, the general business situation, which has made its contribution to unemployment and declining rents, and a tightness of mortgage money. In the face of present conditions, which

have brought declining incomes from properties, unusually heavy serial payments have in some instances thrown issues into default, whereas a more scientific treatment of underwriting problems in certain instances might have gone far toward relieving the present situation.

In order to avoid as far as possible the possibilities of trouble in a period such as we are experiencing, in addition to improvements in underwriting methods, the underwriters of real estate issues will do well to provide themselves with the mechanics for a more careful supervision of the properties underlying their securities. Let me repeat that careful management is a consideration of major importance in the real estate field. It must be remembered that few real estate corporations publish reports, earnings statements, and so forth. It is a much simpler matter to check the condition of a well known industrial corporation, such as United States Steel, than it is to keep in close touch with the earnings and condition of the average corporation owning and operating a large hotel, apartment, or office building. For this reason the underwriter of real estate issues should obtain monthly reports from all his borrowers, and audited statements periodically, especially from the larger borrowers. These statements should go to a department organized for the purpose of management supervision, where they are carefully analyzed for information as to trends of earnings and operation. Coming events cast their shadows before them, and these shadows can usually be detected before they have a chance to blacken the horizon, provided a careful watch is maintained.

The furnishing of such statements

should be an obligation set forth in the trust indenture. Also, if the trust indenture provides for monthly payments toward the meeting of interest and serial payment or sinking fund charges, provision should be made, too, so that the underwriter can step into the active management of the property, should he deem it necessary, if the payments are not made as required. This is a businesslike procedure, made necessary, I feel, by certain conditions affecting the issuance of real estate securities, and, if followed rigidly, will serve to safeguard the underwriting house and its clients from troublesome situations.

FORECLOSURE TO BE AVOIDED

I believe you will all agree that foreclosure should be avoided as far as possible. In many states our foreclosure laws are somewhat antiquated from the point of view of the need of modern real estate bond financing, and consequently do not permit the type of prompt action that is necessary to avoid long delays and expense.

I have mentioned that the tightness of mortgage money has contributed to the present situation. The general apathy of the bond market and the demand for bonds also have their effect upon the re-financing of maturing bond issues. When such difficulties present themselves, it is unwise to attempt to solve the problem by foreclosure. A much more constructive program is to attempt to work out an extension plan which will carry the loan over the period to a time when re-financing will be less difficult. It is of course necessary to secure the consent of all the bondholders to do this, and consent is much more certain provided the extension is not too long.

As a practical matter, it is much better to work out such extension plans in the form of a new issue, giving the old holders the new bonds. This plan will permit you to work out an arrangement with the borrowers to put up a certain amount of funds to afford you a leeway in case it is impossible to obtain the consent of all the bondholders.

If the issue has gone into default because a principal payment has not been met, the holders of the unpaid maturities can be prevailed upon to delay action, provided the funds to clear up the default can be anticipated with a degree of certainty within a reasonable length of time. Or, in cases where it is deemed advisable to do so, the unpaid maturity and all the later maturities can be extended to the last maturity, and a sinking fund set up to provide for a reduction of the indebtedness by the calling of bonds during the balance of the life of the issue. In such instances, the extended bonds must be stamped to evidence the holder's consent and to give new holders knowledge of the extension, should the bonds be sold.

IMPORTANCE OF CAREFUL EXTENSION PLANS

Experience has demonstrated that wisely worked out extension plans are beneficial to the holders. Where they are advisable, the properties are earning more than interest charges, and the holders are certain of receiving their interest. Also, the sinking fund will work toward a reduction of the loan. It is very probable that many of the holders of the earlier maturities will have had their bonds taken up or called through the sinking fund

prior to final maturity. If an extension plan with a sinking fund is applied to a serial maturity issue where a maturity prior to the last is not paid, it amounts to the same thing as a change in the form of the set-up. There are, of course, many angles to this question which time does not permit our discussing here this afternoon. If there are any questions, however, I shall be glad to attempt to answer them in the discussion to follow.

A PROTECTIVE COMMITTEE

In certain instances, in fact, I believe in the majority of cases, it is wise to form a protective committee for the working out of troublesome situations. Generally speaking, however, I do not believe it advisable to turn an issue over to a protective committee, unless careful analysis of the situation discloses that foreclosure is necessary. When it is decided that foreclosure is the only way out, a protective committee is necessary to serve as a vehicle for the bondholders to obtain concerted action. Real estate bonds have been distributed generally to small holders. In the larger issues there may be 2,000 or 3,000 holders and it is perfectly obvious that it would be impossible to get such a group or even a large percentage together to insure proper representation and the most favorable settlement, except through the organization of a protective committee.

Of course it goes without saying that the personnel of a protective committee should be chosen with care. Capable bankers and experienced real estate men should be among its members. Also, the underwriting house should, I believe, make every effort to get its clients to see the wisdom

of depositing their bonds. It must be remembered that in a foreclosure sale the protective committee represents the depositing bondholders only. I have it on the authority of a man of wide experience in working out troublesome situations in the general corporate as well as in the real estate field that in more than 90% of cases, the depositing bondholders have fared better than the non-depositing bondholders.

After the property has been purchased for the depositing bondholders at foreclosure sale, it is then the duty of the protective committee to settle with the non-depositing bondholders and issue new securities to the depositing bondholders, after a sale of the property has been consummated to a new owner who will operate the property. If the property is sold at foreclosure sale to an outside party, both depositing and non-depositing holders will receive a cash settlement. When bidding at the foreclosure sale the protective committee may let the property go to another bidder, provided his bid is above the up set price, and the price offered, in the opinion of the committee, represents a more favorable settlement for the bondholders than could be worked out through other means. The protective committee has full power to act for the depositing bondholders in such cases, and, where the committee represents a large percentage of the bondholders, the court usually will be guided by the committee's wishes.

I realize that this discussion has been very brief and quite general. It is an intensely interesting phase of the general subject of real estate finance; however, our time is limited, and I shall sum up by saying that the time-tested and proved methods which have

been employed in the working out of issues in the general securities field can be applied with certain modifications and adaptations to the real estate field. The house handling such situations should be prepared to exert every effort to work out as equitable a settlement as possible, and above everything else should deal with its clients in an open and straightforward manner. Investment difficulties are not new, and there is no reason, business and human nature constituted as they are, that the real estate field should not come in for its share of grief. To minimize the possibilities of trouble and grief is the problem of all investment bankers.

In concluding my remarks on troublesome real estate situations, I want to emphasize the idea that real estate security, because of its inherent stability and wide utility, has equally good if not better chances of working out of trouble 100% than perhaps any other type of security. It must be remembered that when an issue goes into default it does not mean at all that the assets have been dissipated. The land is there, and apartment, office, and hotel buildings have wide utility and can without great expense be remodeled to meet a variety of uses. You cannot take away the potential earning power of well located real estate. Because of these facts, I believe we can say with confidence that defaults of real estate securities are not nearly so serious from the standpoint of eventual loss as defaults in the industrial field. All other things being equal, the possibility of having to sell improved real estate at so-called junk prices is very remote.

With respect to the future distribution of real estate securities, let me repeat that the financing of construc-

tion and building activities is as essential to our future prosperity and economic welfare as any other major type of financing. It may be a long time before we witness another building boom such as the one we saw in the period from 1919 to 1928. However, the distribution of sound real estate bonds will continue to occupy a position of major importance in the investment field. The refinancing of projects, alone, will insure a tremendously large amount of financing from year to year.

DISTRIBUTION OF REAL ESTATE BONDS

Future financing in the field of real estate issues is certain to become more modern, and we shall see a more general adoption of principles and methods which have proved sound and stable in other fields of finance. As to equity financing in the real estate field, while it is true that the obtaining of equity money in real estate financing is a problem, I, personally, feel that there are certain very definite difficulties in the way of a widespread sale of stock in the real estate field. This does not mean that there is not room for the distribution of preferred stocks on stable projects. I do feel, however, that some means for obtaining equity money must be resorted to other than a wide sale of stocks to the public.

Discussion

A. GORDON PATTERSON (First National Bank, Pittsburgh): Mr. Carson, you say that there is objection to listing stocks on construction projects. Doesn't that in itself indicate that it is poor policy to sell bonds

on construction projects? In other words, bonds as senior security should have a premier position. As I understand it, in all other types of bond financing, the property behind the bonds has already demonstrated its earning power. In the case of real estate financing, your weakness, as I see it, is that the land value, which is the only tangible thing, is only a small portion of the total project. Your building is a business enterprise and as I see it the bonds are sold on the security of the total project. Your bondholder is somewhat in the position of the stockholder but the securities are sold on the basis of bonds. Don't you think that a good many of the present issues of real estate bonds would have been eliminated if equity financing had been done?

THE CHAIRMAN: I did not say that I did not believe in equity financing. I do not feel that equity financing in real estate will develop as in other fields of financing. That is all I mean. I agree with you thoroughly that more financing should be done with equity money. We must orient ourselves, when we consider bonds, from the standpoint of stabilized earnings. Generally speaking, an enterprise without a good earnings record does not make good security for bonded indebtedness. When organizing a new industrial enterprise, you do not as a rule, except in the public utility field where you are assured of stabilized earnings, follow the practice of issuing bonds, do you?

In the real estate field, in underwriting, we have not in the past considered the business risk sufficient. In the real estate field you have a somewhat different situation from other fields. I am talking from the standpoint of the well set up issues, where

you have a borrower of unquestioned financial responsibility who puts in a large percentage of equity money, and where the issue is based on a very conservative valuation of the property. You have a building and equipment whose principal value is value in use. The property may be very specialized in character. For example, if you construct a building which is devised and equipped for the assemblage of automobiles by piece work, and that business should fail or not even get started, the building will prove almost valueless to you. A general commercial building, when completed, has a wider use than a specialized industrial building. You should, therefore, be governed by the point of view of diversification of use when considering a proposed real estate underwriting. You should also arrange your financing so that it can carry you over from the start. You cannot open up an office building and expect to have a lineup of tenants reaching a block down the street ready to occupy the building. Neither can you expect an apartment building to be occupied 100% week after week. It is too much to expect. I know a large hotel in Chicago, in the underwriting of which they did not expect the hotel to make any real earnings for the first five years. It is well taken care of, however. All these things were taken into consideration in the underwriting. I do not believe that because of the absence of an earnings record, bond issues on construction projects should not be underwritten.

I believe it deserves a clearer analysis than is generally given it, because of the stability of value generally characteristic of real estate and the variety of uses to which improved real estate can be put provided the

improvements are not too highly specialized in character.

MR. PATTERSON: My own observation has been that people who buy real estate bonds generally are small investors and think of real estate bonds first in terms of their own houses. They have never seen a residence go begging for occupancy because those values are pretty well established. I believe these investors do not realize that a thirty-story building is a good deal more of a speculation than a ten-room residence. For one thing, it requires excellent management. In our own particular city of Pittsburgh, we have had an unfortunate experience because of overbuilding. It seems to me that such considerations have not been brought to the attention of the bondholders—that they have not been warned of the hazard of speculative risk.

MR. CARSON: There is perhaps a great deal of truth in what you say. However, perhaps it can be said that generally speaking, in selling all types of bonds, we have not talked enough about risk to our customers and have sold bonds to many of our clients who should not have bought bonds. It is my belief that the small investor's purchases of bonds should be most carefully analyzed. If a man walks into the average bank of this country and says: "Mr. Jones, I have a thousand dollars and should like to buy a bond," I contend that Mr. Jones will lay out four or five circulars, and will sell Mr. Prospect a thousand-dollar bond without further ado. Really what Mr. Banker should say is this: "Mr. Prospect, is this the only thousand dollars you have?" If Mr. Prospect answers, "Yes," Mr. Banker should say, "I don't advise you to buy a bond. Let's go to the

savings department and open a savings account for \$1,000; then as you save more and wish to invest we will work out an investment account for you."

There are thousands of people holding bonds in this country who have no business holding bonds. Many investors of small means have all their savings invested in bonds and they have absolutely no liquid reserves to fall back on in case of emergency. In all phases of the investment business, I believe we should teach our clients more about risks and make ourselves more useful in plotting a well balanced financial program for our clients.

MR. PATTERSON: I noticed that you said that real estate projects are largely local in character. It seems to me it has been an unfortunate experience of a great many investors that they have bought bonds in foreign projects; I mean in other states or cities. As a rule they are comparatively small issues and the distributor's representations were excellent and in most cases true, but in case of trouble the investor is frequently far from the center of operations and it is difficult to get any action.

MR. CARSON: The bondholder then has to rely on his underwriting house. The underwriting house has to take care of the bondholders in that case and in so far as possible safeguard their interests.

WILBUR FUNDERBURK (Commercial National Bank, Shreveport, Louisiana): You answered part of my question in answering a previous one when you said that real estate developments ordinarily require from one to five years before their earnings records reach the property's full earn-

ing capacity. I have had occasion to check earnings statements probably several years after the original circulars were brought out and note quite a wide divergence between those earnings and the earnings as stated in the circular as estimated earnings. Do you think that the earnings should be estimated principally for sales talk and then not come up to the earnings in the next few years, or should the earnings be more conservatively estimated in the future?

MR. CARSON: I do not think any estimate should be made for sales talk. However, it is true that a great many overestimates have been made honestly. For instance, when the demand for outlying hotels in Chicago was such as it was a few years ago, it was difficult to be pessimistic with respect to the future of such buildings. It was the same with office buildings. Until two or three years ago, Chicago had a lower percentage of office building vacancies than perhaps any of the larger cities in the country.

JOHN L. BRICHETTO (Security Bank of Chicago, Chicago): What would you say as to the future of equity financing in the real estate field? Would you care to state briefly your opinion of changes that might take place?

MR. CARSON: I have covered that a little. I think, probably, that in the real estate field we have room for a large use of certain organizations like Bing & Bing and The Starett Construction Company, corporations of recognized experience and ability and financial standing, which make it their business to own, operate, and manage hotels, office buildings, and other real estate projects. Equity financing through such companies, where you

have an earning record and where the stock represents the stock of a corporation and is not dependent entirely upon the earnings of one building, one project, is certain to be much more stable. Equity financing on individual projects, however, is very difficult and has its limitations.

I think the forms of securities will remain somewhat as they are. I think we will continue to sell first mortgage bonds. Good first mortgage bonds are as fine a form of investment as certain types of investors can possibly have in their portfolios. An investor should have nothing but first mortgages. However, first mortgage bonds have a place in the investment account, particularly of the large investor, where they can go into the reserve fund; there, marketability is not a great factor.

MR. PATTERSON: In your opinion, what is the chief reason for the past unfavorable action of the real estate bond market aside from the depression in real estate values? Do you think that was sufficient to justify the unfortunate position of real estate bonds?

MR. CARSON: I do not think that the situation as far as real estate is concerned, as far as the actual underlying security is concerned, is nearly so serious as it is pictured. Neither do I think that the situation has been caused entirely by overbuilding. I think the lack of marketability, general marketability, and the slowing down of demand for bonds as a result of the stock market movement have had a very depressing effect. Recently, in fact for some months, almost all of us in the real estate bond business have had an opportunity to buy back more bonds than we have been able to sell.

Judging the Relative Merits of Investment Trust Securities

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Address before the Denver Departmental Conference

Half the troubles of life would be averted if mankind were content to guide the course of the present by studying the experience of the past. In his scholarly paper on investment trusts Dr. Kaplan urges for America just such a scrutiny of the road already traversed, for he sees the genesis and development of the investment trust in this country as paralleling its earlier history in Great Britain.

The chief factors which will make for the success of the investment trust in America are, then, those which have established it successfully in England: efficient management, broad diversification, frankness with the public, fairness to all investors, and an ideal of permanence.

THE great number and variety of investment companies that have taken on the title of investment trusts, would suggest the need of our getting together at the start on what we shall include under the term investment trust. When we come to common ground on that moot point, we have two approaches to our subject: we may judge the merits of the investment trust principle as against other methods of investment, and we may compare the merits of the different kinds of investment trusts and their policies.

At the risk of disturbing the peace among a group of ladies and gentlemen which includes representatives of finance companies, trust companies, holding companies, trading companies, and others on the borderline of the investment trust, let us set some boundaries for the term. To begin with, the investment trust is a means

whereby the funds of a number of individuals may be placed with a trustee to secure the wider benefits of cooperative investment. The investment of that fund has two primary objectives: first, to build up a well diversified portfolio of marketable securities or equities that will combine safety with favorable yield; second, to preserve and, if possible, to increase the capital value of the composite fund. The equities in the trust are evidenced by its shares or certificates. Where it parts company with other investment forms is on the point that the true investment trust is a disinterested selector of investments for the fund. It is not a means of gaining control of an industry, nor an adjunct to a banking house intended to provide a convenient outlet for the bankers' underwritings, promotions, reorganizations, or related operations. To the extent that the company enters into any

operations other than the supervision of the portfolio, to the extent that it takes on a managerial or financial interest in any business whose securities are selected for investment, it ceases to be, strictly speaking, an investment trust.

ORIGIN OF THE INVESTMENT TRUST

As far back as 1868 a pioneer British group of trustees, styled The Foreign and Colonial Government Trust, issued this prospectus:

"The object of this trust is to give the investor of moderate means the same advantages as the large capitalist in diminishing the risk of investing in foreign and colonial government stocks, by spreading the investment over a number of different stocks and reserving a portion of the extra interest as a sinking fund to pay off the original capital.

"A capitalist who at any time within the last 20 or 30 years had invested, say, £1,000,000 in 10 or 12 such stocks selected with ordinary prudence would, on the above plan, not only have received a high rate of interest, but by this time have received back his original capital by the action of the drawings and sinking fund, and held the greater part of his stocks for nothing.

"Some parties, believing that it would be a convenience to the public if such a mode were made generally accessible, have made arrangements by which well selected Government stocks, to the value of £1,000,000 sterling, will be placed in the names of the following trustees, viz.:

"The Rt. Hon. Lord Westbury

"The Lord Eustace Cecil, M.P.

"G. M. W. Sanford, Esq., M.P.

"George Wodehouse Currie, Esq., M.P.

"Phillip Rose, Esq."

As you who market investment trust securities have undoubtedly pointed out to your clients, the average individual's fund is insufficient to permit a direct holding of securities in a well diversified list of enterprises. The small investor seeking the advice of his banker will be told to seek safety, in 4% and 5% bonds giving him a protected fixed income. In a period of level or falling prices, the bond values and bond incomes hold up, while dividends in common equities may be suspended. But if, as was the case between 1910 and 1920, we have a sharp rise in prices and in interest rates as well as in the cost of living, the value of bonds declines, and their income dwindles in terms of buying power; while the holder of stock equities then enjoys (in the larger dividends from increased profits) a more than proportionate increase in his capital and income. It takes a prudent admixture of credit securities and share equities to hold up values and income. By the same token it takes distribution of securities, over a number of industries and areas, to insure oneself against the obsolescence of any one industry through new inventions or of any one locality through adverse circumstances. Thus, the great merit of the investment trust lies in the opportunities which it gives to the small investor to enjoy, in wide and expert diversification, the chief defensive device for meeting the problems of risk. The size of the composite fund makes possible a handling of the investments which is denied to the investor who purchases his bonds and equities individually.

The new form of investment organization enjoyed a marked favor during the next two decades, and here again we may utilize a bit of history

to bring out the conditions conducive to the successful developing of an investment trust. The great success of the British investment trusts launched in the 1870's and 1880's—their “golden era”—had its foundations in certain unusual conditions that may profitably be tested against our own American investment trust boom.

These were:

1. That interest rates in England were abnormally low. British consols were on a $2\frac{1}{2}\%$ basis, and good bonds generally did not yield more than 3%.
2. That investments at higher yields were available on the Continent, incidental to the rise of the German Empire and to the industrial renaissance in France.
3. That British capital was in demand for the execution of England's wider imperial policy. At the same time, the United States was entering its period of big business, and South America was likewise ripe for development. In the New World, comparatively sound investments would pay 4% or 5% higher than home securities of similar character. The liberal rates in the United States were enhanced by the fact that the pound sterling was worth more than \$5 in American currency.
4. That the small British investor, grown cautious after the orgy of speculation that had wiped out the savings of British workmen in the 1830's and 1840's, mistrusted his own judgment in seeking lucrative foreign investments. His requirements for skilful appraisal of investment opportunities found a logical response in the evolution of the investment trust, under the

guidance of British banks, with their worldwide command of credit facilities and investment opportunities.

Here was a perfect setting for the typical British organization of an investment trust. For the participating investors, the trust issued share units, which were usually redeemable into a share of common and a share of preferred stock. With the fund from shares as a base, it readily borrowed additional capital at 4% through the issue of debentures. Thus, if for each £500 in ordinary shares and £500 in preferred (at say $4\frac{1}{2}\%$), there were £1,000 in debentures bearing 4% interest, the fixed obligations of the trust would amount to only $3\frac{1}{8}\%$ of the total portfolio. This was more than earned with a backlog of seasoned bonds, including foreign and colonial issues that paid more than the current home rate and yet left the trust free to invest a part of the total fund in promising and well diversified securities that were perhaps less conservative but more lucrative.

Besides the regular annual earnings, that ran well ahead of interest and fixed dividend requirements, additional surplus accrued from profits realized on judicious turnover of holdings, or occasional participation in new underwritings. The reserve built up from such sources not only served as additional safeguard for meeting the fixed obligations of the trust in periods of depression, but also provided additional capital for investment, to the profit of the shareholders. Moreover, the accumulating reserves strengthened the borrowing position when additional capital opportunities developed.

These early successes soon provided a demonstration, however, that the investment trust offered temptations as

well as merits; that it was a dangerous instrument indeed, in any but very competent hands. Additional companies entered the field in the late eighties, as the securities market worked upward; they staged a brisk competition for the attractive investments. Debentures at 4% were no longer easy to float; bargains abroad, 7% to 9% issues, became correspondingly scarcer. The newer trusts had either to buy the seasoned securities at peak prices, or else, as a number of them did, to desert the backlog securi-

Many elements in the code of the representative British trust have found their way into the charters of the best American trusts of the discretionary or management type. The principle of diversification is broadly construed: only a limited percentage of the portfolio goes into any one industry, or into any one country. The portfolio is closely watched, and reinvestments are made as opportunities arise, but the main reliance for income is on interest and dividends on securities owned, not on trading profits or other

Company	April 1891	April 1890	Movement
Alliance Investment Trust.....	75	109	— 34
Bankers' Investment Trust.....	84	111½	— 27½
Colonial Securities Trust.....	55	90	— 35
General & Commercial Investment Trust.....	70	101	— 31
Government Stock Investment.....	75	111	— 36
Investment Trust Corporation.....	120	143	— 23
River Plate Trust Loan & Agency.....	178	287	—109
South African Gold Trust.....	100	300	—200
Trustees, Executors & Securities Ins. Corp.....	182½	225	— 42½
United States & South American Investment Trust	79	104	— 25

ties altogether for speculative issues, like the 10% municipals floated by towns of mushroom growth in the new West of the United States. Entering at height of the market in 1889, the newer investment trusts went under in the crisis that accompanied the failure of Baring Brothers in 1890. Even the well established companies were deserted for a time by the public, their shares showing declines of from twenty-five to two hundred points within the year.

Above are the market prices of ten British investment trusts before and after the crisis of 1890.

From the lessons of this period the British companies developed a technique of efficient investment that has made the British investment trust a standard by which our later American examples may be measured.

extraordinary sources. That is to say, securities are acquired to be held for regular income, and not for market manipulation. When profits are realized from turnover or underwritings or the exercise of rights, such profits are not paid out as dividends, but are diverted to the reserve fund. Thus, when the market drops and bargains are to be had, there is available capital with which to make desirable purchases. Adhering to practices of this character, the British trusts went through the World War with flying colors. In the face of a declining market for securities during and after the war, the British investment trusts enjoyed a steady rise in value, as they took advantage of low prices and joined in the financing of promising enterprises in whatever corner of the world they might arise.

The success of the British investment trusts in weathering the difficulties of the war and of post-war adjustments is reflected in the market prices of the seven trusts given below—statistics taken from *Investments Abroad*, by A. E. Davies, p. 162.

Little wonder, then, that in the United States there arose a strong post-war interest in so attractive a form of investment.

INTRODUCTION IN AMERICA

We have seen how the rise of the British investment trust was timed to

senior preferred issues. Their prospects were built on the heavy profits of Big Business, in whose common stocks they were investing. The optimism of the promoters is evidenced in the fact that several issues of preferred shares were floated at 7% and 8%, while nearly all of the regular debenture issues carried common stock warrants as a bonus. The favorite holdings of the investment trusts were yielding an average dividend of less than 4%, as is shown by the table on the page following.

It is obvious, therefore, that many American investment trusts were to

Company	Price of Common Shares, in £		
	1909	1913	1926
British Investment	212	267½	400
Indian and General	73	109½	225
Industrial and General	134½	177½	310
Invest. Trust Corp.	182¼	226½	400
Mercantile and General	96	123½	245
Merchants Trust	110	137	203
Gov't and Other Securities	87	118	170

a period that offered it special opportunities for popularity and success. In the post-war situation of this country, financial promoters likewise saw factors that made the time appear propitious for the launching of an American investment trust development. Likewise, also, the prevailing conditions determined the character or characters that the American investment trust would assume.

In one very significant respect, the American founders of the investment trust faced a less favorable situation than did the earlier British generation. American investment trusts did not have an easy market in which to borrow their capital, with the government victory bonds at 4¾% and United States Treasury certificates at 5½% and 6% on their debentures and their

depend for their income mainly on the exercise of rights and on quick trading in the rapidly rising market. It is a familiar fact that the year 1929 ushered in a number of companies that frankly assumed the title of trading corporations. One of these, which has had a spectacular career and is known to all of us, reported for 1929 a total income of \$25,646,074, of which the income from interest on investments was but \$2,787,116; from dividends, \$3,696,575; from profits on sales and participations, \$19,162,383. From the standpoint of quick profits, there was much to recommend the trading organizations during a rising market. But when the trend was in the other direction, was the trading company to be an investment trust for short selling in

a declining market? Obviously this would be a far cry from the traditional British investment trust that was held up as the shining example in the launching period of the American investment trust. What happened to American investment trusts in the market crisis of last October and November was as natural as what happened in the British experience of 1890. Just as the market prices of American investment trust shares went skyrocketing, during the boom, to

been considering up to this point is the general management trust, in which wide discretion is vested in a board of trustees or managers, who supervise the investment of the fund. The degree of management varies in different trusts from absolute discretion to a rather strict limitation of investments, as to the industries or types of securities in which investments may be made, and in the general rules governing their selection. In the United States, as a logical outcome of the

YIELDS ON THE TEN SECURITIES MOST WIDELY PURCHASED BY AMERICAN INVESTMENT TRUSTS

December 1928				September 1929			
	Mean Price	Div.	Yield	Mean Price	Div.	Yield	
Am. Tel. & Tel....	\$190.00	\$9.00	4.74%	\$295.00	\$9.00	3.05%	
At. Top. & S. F....	196.75	10.00	5.08	281.00	10.00	3.55	
Columbia Gas	132.00	5.00	3.79	116.00	2.75	2.37	
Cons. Gas N. Y.	102.87	4.50	4.37	167.25	3.25	1.94	
Elec. Bd. & Sh.	174.50	..*	..*	179.00	..*	..*	
Gen. Electric	198.75	6.00	3.02	374.50	6.00	1.60	
N. Y. Cent. R. R. . .	186.25	8.00	4.30	237.00	8.00	3.38	
St. Oil N. J.	54.62	1.50	2.75	75.00	1.87	2.49	
Union Pacific	211.75	10.00	4.72	280.00	10.00	3.57	
Union Carbide	188.87	6.00	3.18	130.00	4.30	3.31	
Mean			3.99			2.81	

*Six percent stock bonus.

heights that were far above their true values, so their prices tumbled to lows that were well beneath their actual liquidating values when the public learned that certain popular organizations had been purchasing securities at peak prices just before the boom. Page 595 shows examples of the effect of the market turn of last November on the prices of investment trust shares; their market values, it should be noted, are expressed as a percentage of their liquidating values in each case (liquidating value 100%).

THE FIXED INVESTMENT TRUST

The investment trust that we have

post-war vogue for common stocks, we have witnessed the development of the fixed investment trust—a characteristically American application of the principle of diversification. The fixed trust may be regarded as the tangible result of the doctrine preached by one school of American economists and eagerly taken up by investment promoters, that the most lucrative long term investment lies in the common stocks of corporations which represent a fair cross-section of American industry. Between January 1927 and April 1930, ninety-five fixed investment trusts were launched, with an aggregate share value in excess of a quarter of a bil-

lion dollars. The blocks of twenty or more common stocks that compose the usual fixed trust units have generally been chosen with discrimination. The average fixed trust share is a fractional interest in a fair cross-section of American industry, as represented by the securities of the leading corporations in various lines. Nearly all of the fixed trust shares now on the market have earned a high rating from the standard rating agencies. Nevertheless, we must bear in mind the fact that the American fixed investment trust is essentially

ing decline. (A partial offset against such a contingency is offered by some fixed trusts in the provision that when any security in the unit suspends dividends, the security may be sold and another substituted with the proceeds thereof. But that may be closing the stable after the horse is stolen.)

The fixed investment trust is thus, in the final analysis, for the investor who would hold equities in American enterprises because he believes those equities will enhance in value as they have done in the past. If that be the case, it has a bearing on the relative

Company	Dec. 31, 1928	Dec. 31, 1929	Mar. 31, 1930
Alliance Investment Corp.....	273.0%	183.0%	....
American British & Continental.....	243.8	138.6	....
American & European Securities.....	233.1	75.7	87.8%
Incorporated Investors	155.0	104.9	104.1
Joint Investors	430.7	122.2	94.8
Massachusetts Investors	101.0	102.0	....
Mohawk Investment Corp.....	102.7	99.5	103.0
Shawmut Bank Investment Trust.....	176.1	94.3	....
Sterling Securities Co.....	206.2	114.8	121.0
U. S. & Foreign Securities.....	216.0	71.0	....

an investment in common stocks. It is an excellent way to buy a diversified equity in common stocks. But in so far as the investment trust may be sought by the small investor who demands safety and steadiness of income, the units of the fixed investment trust—at least the present variety, consisting exclusively of common stocks—do not make a backlog investment. In a period of depression, when industrial profits are low, even a well diversified holding in common stocks may yield insufficient income. Then there is the often noted risk, in the case of the rigidly fixed unit, that one or more of the securities in the fixed list may turn out unfavorably yet must be held along with the rest despite the signs of approach-

merits of the distributive and the cumulative type of the fixed investment trust. In the distributive type, as the term implies, all dividends from the portfolio, including stock dividends, and all rights or warrants, are sold and their proceeds are distributed to the shareholders in the trust. But the exercise of such rights or acquisition of additional stocks in the active corporations offering such privileges, constitutes one of the chief methods by which the value of the common stock investments is increased. The dissipation of such opportunities through sale and distribution of proceeds destroys one of the great advantages of participating in an investment trust. The cumulative type more definitely recognizes the

character of the common stock investment. It preserves and increases its equities by withholding a part of the dividends from securities held, and builds up a reserve fund with which the privileges may be exercised, while retaining all stock dividends. In this way it permits the full benefit of long term holding in the equities of the major American industrial enterprises. In short, so long as the fixed investment trust confines its portfolios to common stock, it should operate along the lines appropriate to the "business man's investment," where immediate annual income is secondary to the expectation of future profits from an enhancement in the capital value of the equities.

GUIDING PRINCIPLES

I can see little in our American experience with the investment trust thus far that calls for any modification of the principles worked out and successfully applied by the established British investment trusts. If anything, the market crash of last fall has vindicated their more conservative traditions. The more important of these may serve us for a summary.

The first generalization that needs to be made is, that the character of the management is more important than any rules that may be laid down in the charter, in judging the merit of an investment trust. Only a trust that is in command of competent advice on investments, that is in close contact with industries and markets, and that is at the same time in the hands of men whose judgment has been tested in business and finance, can expect to operate successfully through the ups and downs of modern markets.

Considering the rapid changes to which modern industry is subject, broad diversification is of utmost importance to the investment trust. From the fragmentary information that is available on the inside operations of American investment trusts, it is already clear that those who rode their hobbies hard were among the chief sufferers in the showdown. In this connection the relatively strong market showing made by the fixed trusts through the recent depression was due in a measure to the visible diversification represented by their units, in contrast with the doubt that has existed about the holdings of many management trusts. The danger to be guarded against in the case of an investment trust which is an adjunct of a general investment banking house or a holding company, is that such an organization may sacrifice diversification in favor of the particular industry or flotation in which it has a financial or operative interest. In the United States there is the feeling that all the diversification we need may be had in our own domestic securities. When the relative movements of the markets of different countries are more widely studied, it will be seen that they do not move uniformly. It is interesting to learn that while American investment trusts were concentrating on domestic securities last summer, British companies were dumping the overpriced American favorites to substitute European securities that had been depressed in price, or held their ready cash until after the crash in the United States, and then became, as we know, heavy buyers of American securities at the bottom. The limit to diversification, in principle, is set by the facilities of the investment trust for watching all its securities.

An investment trust that expects the confidence of investors must be prepared to issue a list of its holdings at least once a year as part of its annual report, and preferably semi-annually or quarterly, as many of the best investment trusts do.

The charter of an investment trust must be fair to all types of investors therein, whether common shareholders or bond creditors. Several investment trusts have hypothecated their holdings to bondholders or prior-preferred shareholders under conditions that seriously and unnecessarily undermine the equities of those who hold the junior shares. This is as bad as failing to give debenture holders adequate protection, by limiting the amount of borrowing against the portfolio.

Above all, the sound investment trust must be devised and conducted along lines that make for permanence. Intrinsic values and income earning power must be the first consideration; market opportunities must not be accepted at the expense of a balanced, income-earning portfolio. Profits made through judicious exercise of right, or of underwriting privileges or turnover, belong to reserves against emergency periods. The record of British investment trusts, which have gone through every crisis since 1890, and through marked fluctuations in market values, without a break or even a drop in their payment of dividends, furnishes the objective toward which the best American investment trusts will shape their policies.

Discussion

LEO TALLEUR (Miller Investment Company, Chicago): Dr. Kaplan, would you differentiate between the trading company, the holding company, and an investment trust?

DR. KAPLAN: As far as the management type of investment trust in relation to a trading company is concerned, I should say there need not be a difference in the organization of the trading company from the management type of investment trust. It simply means a shift of emphasis. It may be a company that started out as a management type of investment trust, saw opportunities for quick trading, and did not feel enough confidence in the portfolio to be satisfied with the income that it could get from the securities in the portfolio, and so took in trading.

It is true that certain so-called investment trusts were organized as trading companies to take advantage of the rapid rise of stock in this country. It seems to me that there is no necessary difference in the organization set-up of the trading company and the management company. It is simply a difference in its ways of doing things. The trading company, it seems to me, is something for the type of person who wants "a run for his money" and wants to play. I do not think a corporation that depends on trading for income is the type of corporation that we ought to associate with the long-pull type of management trust.

The holding company is interested primarily in some particular line of industry or some related group of industries. The primary object is to gain control of the industries, and it is a perfectly proper object. But I do not regard the holding company as being of the same class as the investment trust that has no particular interest in any particular line of industry but is seeking only the widest possible diversification in the selection of securities for the trust without

the relationship of the manager to those securities as in the holding company. The managers are able in the particular line of industry, when operating in that industry, to select these securities for the sake of making their operations more effective.

WILLIAM N. POPE (First Trust & Deposit Company, Syracuse): I wonder if Mr. Talleur is referring to the double holding company, such as the First American Shares, now being organized, where they have accepted management stock; also, if the British originally had two types of stock.

DR. KAPLAN: The British, of course, have holding companies. I think the distinction is very definite between the holding company and the investment trust per se. The holding companies are very often so closely associated with the cartel and syndicates abroad that they are referred to as syndicates or cartels.

Take for instance, Coates Ltd. of England, which has holdings in almost every line related to the textile industry; a tremendous investment trust, in the American interpretation. It is strictly a syndication of related groups that are under central control.

Some of you are familiar with the United Founders Corporation that has taken over a group of related companies, with the Schroder group, and with other related groups that have consolidated. There is no limit to the amount of pyramiding that can be done. The British do that, and it is confused with the operation of holding companies. That is, eight or ten industries, operating independently of each other, very often get together on a joint undertaking along with their subsidiaries; they like to have a little reserve fund with which they will take some chances in new enterprises. They

have not yet caught the stock market fever and will get together on a written understanding of that sort.

THE CHAIRMAN: Dr. Kaplan, a moment ago you said the fixed investment trust was a good way to sell common stocks. Would you say that the fixed investment trust, properly set up, is a good way to buy common stocks?

DR. KAPLAN: I think one of the reasons why it is a good way to sell stock is that it is a good way to buy stocks. Naturally, the investor who has a limited fund, that would not go very far when he was attempting to buy individual stocks on his own account, sees a great attraction in the possibility of buying fractional shares in a number of stocks; it seems to me he is getting something better in that respect than if he were to buy the individual stock, but he is buying common stock equities in any event. His purpose there is to realize from the increase in common stock equities. I do not feel he is in quite the same position as the management investment trust investor who is thinking of steady income with slow increase in his estate over the years. I think the fixed investment trust has its very definite place for the investor who has reason for buying common stocks.

A. GORDON PATTERSON (First National Bank, Pittsburgh): Dr. Kaplan, in the absence of that seasoning which you say the investment trust lacks, how would you approach the proposition of investment in investment trusts? What factor would you look for? Would you want to know the portfolio or would you be more interested in the management? Suppose you were the investor. How would you approach the problem?

DR. KAPLAN: I am inclined to

think that the quality of the management would be the consideration with which I should start, because I am going to turn over my funds to this group with the understanding that I will not be able or shall not expect to watch those funds. In the first place, I want to know that the people who are at the head of the management organization are men who know how to judge stocks. I want to make sure that there are men in that management who have had experience with securities. I want to make sure that they have an organization that is equipped to do scientific judging of securities. If I find that the investment trust has that type of management, I am perhaps interested in the kind of powers that that management has.

The organization may be such as to afford excellent management for a single group of stocks; that is, for an investment trust which is going to purchase only Standard Oil stocks. There are two or three very good investment trusts that confine themselves that way. My feeling is that I do not want to invest in a single industry and in that particular trust. Some may feel that they have enough other things and want to concentrate on oils. That is perfectly proper, and in that case they are not interested in the fact that the portfolio is limited; in fact they may even want a portfolio that is limited.

I say that the management comes first; however, I do feel that the safeguards thrown around the portfolio are also very important. I have this in mind, for instance: suppose I want to buy the common stock of an investment trust that is so anxious to please the debenture holders and first preferred holders by giving them the

maximum of saving that whenever the liquidating value of funds goes below 200% of the amount of debentures outstanding, they call in the debentures and foreclose. Certainly the common stockholders would not want to go into that type of trust. "A type like that, which has a 50% mortgage of that sort would not be the highest type of gilt edged investment for me," says the common stockholder. "I would be in the position of one ready to be foreclosed on at any time." There are two that can foreclose on a common stockholder. If I am thinking in terms of common interest, surely I want the debenture and preferred stockholders to be protected, but not to the point that I am virtually buying on margin. So, in that sense, the portfolio has to be watched. The portfolio should be analyzed also from the point of view of diversification. For myself, I believe that diversification should be limited only to this extent: You don't want a large group of widely diversified stocks if your organization isn't strong enough to watch them all. But within those limits I certainly feel that the management trust should take advantage of every opportunity for diversification. The more varied the diversification, the better I should like it for myself, except that I do not want to diversify to the point where I cannot watch it. I would not consider 400 securities too large for a portfolio, but some would be better off with twenty-five or thirty in the portfolio.

I think, out of the long time experience of the British we have learned that the high quality type of management is the first essential; if you have that, you need not worry about the safety of the management group.

ORVILLE M. STREIFF (State & Trust Bank, Highland, Illinois): In the banks, until we can definitely tell what the management will be, what the investment trust will do in this country, just how would you follow the problem out until we have arrived at a stage where we can judge the management better?

DR. KAPLAN: It seems to me that the average lay investor would do well to take his banker's advice, in the first place, on the type of the investment trust in which he is going to invest. Now assume that he comes to the members of this group for advice. It seems to me that there should be no difficulty on the part of a group of this sort and those you represent to get very definite information on the kind of people who are managing that investment trust. The names of the managers are well known to you; the affiliations are comparatively easy to find out. You can find out from their affiliations whether they are likely to play certain industries as pets and use investment funds as dumping ground. It is a matter of judgment, of course. We have very few groups in this country that can show seventy-five years of continuous, careful management, in the investment trust field. On the other hand we do have others which sponsor investment trusts which are organizations that have had the respect of people for a great many years. Some of you may recall a Boston managing group that started

an investment trust about four years ago, before they even began to trade their common stock, which started at zero and went up to thirty; this banking house had to send out letters to all the people it could reach, warning them not to pay so much for the stock, because they had not even begun to trade. Yet people insisted on those high prices, because they wanted to get something that that group was to manage.

It seems to me that men in the banking field ought to be able to get excellent, accurate information with respect to the quality of the management. Of course, I am not in the banking field myself, but I do not think I would have any difficulty in naming groups of managers in whom I could have implicit confidence. Their holdings have done some queer things, but it would not discourage me.

Before I sit down, may I call your attention to the fact that I had hoped to be able, through the Bureau of Extension Research of the University of Denver, to prepare in published form a statistical analysis of some particular management investment trusts and fixed trusts over the past three years, which would give some latest statistics for this conference, but I had to be out of town the last three weeks and could not get it here. However, we will be glad to send to any one wishing it a copy of the publication making this analysis of several types of investment trusts.

Savings Banking

The Human Equation in Savings Banking

By ROY R. MARQUARDT

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Address before the Denver Departmental Conference

Mr. Marquardt feels that there are four qualities essential to the young man or woman who is to succeed in banking:

1. Mastery of the facts
2. A new business perspective
3. An open mind
4. Persistent application to the job.

These traits in the personnel mean not only assured success for the individual, but also progress and fine achievement in savings banking as a whole.

AS American business continues its swift development, rushing along at a rate that constantly brings unexpected signs of progress sweeping into view, we begin to see that perhaps the greatest contribution America is making to the world's advance is in the matter of conserving the worker's energies and enlisting his spirit.

Our abundance of capital, our mechanizing of work, our lifting of the burden of manual toil, our sharing of the rewards with the producers—all these have made possible increased freedom, health, and happiness for all who work with brain or hand and have resulted in their bringing each day to office and shop new enterprise, new ingenuity, new inspiration, new breadth of vision.

We have reached the point where this is a conscious effort of management. And while we should not say

that more than a good beginning has been made in this direction, we have achieved sufficient progress to indicate the benefits which can be expected.

We have begun to realize that the most profitable study of commercial bank management, savings bank management, and all management is man. Successful bank management is nowhere more evident than in the team work of employees. Bank systems and plans are but the rules of the game in which employees are the players.

Bank management deals with doing things right, and it is, therefore, to a large extent a matter of the human equation, a problem of how to get the best out of our employees.

In how many organizations do we find a constant tendency to criticize, never to forget errors, but quickly to dismiss, or entirely to overlook real

accomplishments? In savings banking as in all business there is a need for more individuals who are willing to spare criticism, forgive errors, and applaud achievement.

Without the proper spirit among the men, no system or plan will make a business successful. With the proper spirit, almost any plan can achieve some measure of success. And so I should like above all to emphasize this subject of the human equation, for it goes to the heart of successful savings bank management.

Whenever you find the management of a bank maintaining an attitude of absolute fairness and open-mindedness, you will find a bank that is destined to attain new levels of accomplishment. If prejudice can be eliminated, and unfounded opinions, outworn conventions, and personal sentiment forgotten, savings banking may even excel its past development.

THE SPIRIT OF A BANK SHOWN BY ITS EMPLOYEES

Some one has said that you can tell a well managed business by catching a glimpse of the outside of the fence about the plant. By the same token, a customer can frequently sense the spirit of a bank, its efficiency, alertness, and progressiveness, by the most casual and frequently incidental contact with the employees. Every bank can well afford to focus the attention of the management upon this problem of enlisting the employees' genuine and eager interest in the success of the bank. Sound personnel management involves more than loyalty—though some banks have not even begun to secure the hearty cooperation of their employees. It means more than punctuality or

faithfulness. It involves alertness, intelligent thinking, concentration, intense, courageous, and high-spirited application on the part of each employee, not only with respect to his own job, but also to all things that can contribute to the progress of the institution.

All this, of course, is something that cannot be bought with salaries, bonuses, or prizes alone—though it cannot be had without fair and even liberal reward. As it is an expression of the worker's spirit, so it can be aroused only by leadership, personal magnetism, deep and real human interest on the part of those in responsible places.

A well known business counsellor has said, "If my thirty years' experience . . . has taught me anything, it is that we are only beginning to tap the potential right-thinking powers of workers in our shops and offices. We have had and have today an aristocracy of thinking, too much thinking at the top. Thinking is basically democratic in character: there is plenty of it at the bottom, but it is usually unexpressed. Thinking is the chief characteristic of every human being and responds to stimulation We pay high wages, give extra awards as incentives, have welfare plans, and, up to a certain point, all these are productive of results. But the real riches in the mentalities of men, the 'pay dirt' which yields the greatest return through development, have scarcely been touched." I believe there is something profound in that philosophy.

PERSONNEL ORGANIZATION

To manage a savings bank or department successfully, the personnel

organization must be properly planned.

A sound organization plan is not obtained easily, for almost every bank experiences many changes over a period of time. There are customs and old established methods of procedure to be considered. Only a banker who has the ability to detach himself from the bank and see it as it really is can hope to work out the proper personnel plan.

The small bank in its early years, moreover, is apt to run with reasonable smoothness, because its structure is so simple, and the key employees in each department have a good grasp of their specific banking functions. But as the bank grows, departments become larger, relationships more complex, the work of each person more specialized, and both the difficulty and the necessity of coordination increase. If such coordination is not achieved, there is duplication of effort, an uneven flow of work, peaks and valleys, overlapping responsibility, and so on, all of which result in great waste. A savings banker may be thoroughly versed in general banking principles, yet wholly lacking in the ability to organize efficiently.

In any large institution, and especially in one that is making rapid growth, it is imperative that lines of authority and responsibility be defined and clearly understood. For this purpose, every bank will find it profitable to prepare a complete organization chart, which should include at least the officers, and those in supervisory positions. One main purpose of this chart is to put an end to all twilight zones of authority. Friction almost always results from a misunderstanding on this point—and this misunderstanding, whether among

routine employees or those in higher positions, almost always originates at the top. The proper exercise of responsibility calls for the greatest of all executive qualities, perspective, which is the ability to delegate details to specialized employees, who may, after all, be better qualified, and to concentrate the higher paid talent upon really important matters.

Banking calls for great business ability of several kinds. There must be business-getting ability; there must be administrative ability; and there must be technical banking ability. To find all these abilities in one man is unusual. Some of the most successful bank executives have been great commercial figures, with insight, magnetism, and executive ability. They have been leaders rather than technical bankers. But somewhere near the top there must always be an officer who knows all the technique of banking. This is imperative.

An organization plan requires that the work be subdivided and arranged in logical order. Those in responsible positions should be relieved of details and given time to think on major policies and plans. It is never economy to require some one to do a particular task which another person who receives a lower salary can do fully as well. Every officer and employee who supervises others should have an understudy. When a complete personnel plan has been developed, the bank has an efficient group of workers properly supervised, adequately compensated, and happy in their work.

Having set up an organization plan, with lines of authority and responsibility definitely established and duties clearly defined, the task of the management is greatly simplified. But

managing a bank is more than a matter of charts and forms. Mechanical aids are important, but even more important is the human factor. Let us give some thought to the qualities essential to success in savings bank management. If I were to select young men and women of exceptional promise in the savings field, I should expect to find in them certain qualities which experience has indicated as necessary in those who aspire to banking leadership.

MASTERY OF FACTS

The first essential quality in a young savings banker is a complete mastery of the facts in the savings business. A mere smattering of knowledge, careless thinking, shallow reasoning—these are not the earmarks of executive ability. A thorough understanding of all the factors involved in any savings problem is a prerequisite to its sound solution. No individual who has been placed in a position of responsibility in a savings bank will be in command of the situation long before he finds himself face to face with problems that can be solved only by some one who knows the facts in this business.

A savings banker must know his markets. What volume of savings deposits must he have as a minimum to make an adequate profit? What are the costs of handling the various transactions in the department? How should he invest savings deposits so that he may have adequate profits, complete safety, and the necessary liquidity? What losses may be expected? What interest rate should the bank pay? How is this interest rate determined? Is it a fact that in some communities the savings in-

terest rate could be reduced from 4% to 3% and the bank lose 30% of its deposits, and still make more net profits than it did before? What is the answer to that problem? How many transactions—deposits and withdrawals—does each employee handle per month? How does this number compare with other savings banks? If the number is too low, is it because the employees are inefficient, or because the organization plan is not sound?

TANGIBLE PROBLEMS

Here then are some tangible problems. Here is a banking laboratory where any young man may exercise the full capacity of his thinking power to develop those facts essential to the progress of his department. The banking business is stepping into an era of precision, knowledge, and organization, and any young banker who fails to keep pace because he does not know the facts regarding his business, will miss many of the opportunities for progress.

I do not propose an indictment of savings banking, but I do believe that there are too many young men and women in savings banking who do not have a grasp of its basic fundamentals; their knowledge of the facts is wholly inadequate. Savings banking today is more competitive than it ever has been, and no savings bank or department can make money by guesswork. In the matter of employee efficiency, for example, surveys show a wide variation in the number of transactions (that is, savings deposits and withdrawals) handled per person. Some employees are doing 25% more work and are probably getting less pay than others. The cost of han-

dling these transactions varies as much as 300% or 400% in different savings banks or departments. And yet the management, because it lacks the facts, goes on year after year without remedying the conditions, and without showing the proper profits for stockholders.

Work at the windows of a bank is not wholly comparable to factory work, where production comes to the worker in a steady stream and enables him to maintain a steady pace. The work at the windows is uncertain. It has its idle and its crowded hours; and beyond the routine there is the actual sales work which employees can do at the windows. The number of transactions an employee handles is, therefore, not the final test of willingness or effectiveness, but merely a challenge to the management to balance the work and the workers, to avoid idle time by a more flexible use of employees, to know actually what is happening.

Surveys also show that, regardless of the size of the accounts, there are about 30 to 40 transactions per month for every 100 savings accounts. Stated in another way, these surveys indicate that the small account involves as many deposits and withdrawals as the large account; consequently, the larger accounts are far more profitable. Further, if the number of transactions per account per month does not increase with the size of the balance, then as the average balances of the savings accounts increase, the operating expense will decrease. Or, another way of putting it, as the average balance per savings account increases, the operating expense per \$1,000 of aggregate savings balances decreases. And so we may conclude that mastery of the

facts in the savings business is an indispensable tool, and the first essential, to any young man or woman who hopes to succeed. When a savings banker determines to know the facts, he begins to pay the price which banking progress demands.

For the American Institute of Banking student who is on his way up the ladder in banking, the handwriting is plain: "Master the facts, analyze your particular problem of management, break it down, then reconstruct it upon facts that are up to date—but above all, master the facts." While time does not permit me to dwell at length on the knowledge that is necessary for proper savings bank management, I trust I may have indicated the great importance of facts in attaining what may be termed banking success.

But it is not enough merely to have a complete knowledge of the facts. There are young bankers who have mastered a great many of the essential facts regarding the savings business. They have studied costs, efficiency, methods of operation, new business programs, and other plans for increasing profits; but they have failed to act. Some deliberate, some hesitate, and still others procrastinate with the facts in hand, but without the courage and determination to carry their convictions through. A knowledge of facts must always be combined with a determination to act promptly, if success is to be assured.

A NEW BUSINESS PERSPECTIVE

The second essential earmark of executive ability in a savings banker is the proper new business perspective. I appreciate that a great deal has been written about bank salesmanship and

advertising, but their importance can hardly be overemphasized.

The savings banker must command confidence so great that men and women are willing to place the savings of a lifetime and, in a measure, the future welfare of dependants in his hands. He is the steward of the community's wealth. To secure confidence of this kind requires the highest type of salesmanship. The savings banker must be kind, patient, brief-spoken, with a keen sense of honor, and with culture, but above all, he must be sympathetic in his understanding of the financial problems of men and women.

Frequently, bank officers rise to their positions through the operating departments of a bank. They learn the necessity for accuracy in figures, and the responsibility of printed statements, but they lack the proper new business perspective. They fail to see that both the quantity and the quality of a bank's business can be built up through organized selling and new business effort. They fail to see that banks have not always been as aggressive as they might be in their selling, and as persistent as they should be in their advertising. By aggressiveness a bank may materially increase the volume of its business, and the accumulated effort of a few years in an aggressive bank may enable it to excel greatly the institution lacking in salesmanship and aggressiveness.

Every savings bank ought definitely to plan for the active solicitation of new business in its community. In this connection, it is well to remember that there is no magic, no short cut, no get-rich-quick formula, in securing new savings business.

A sure way to outwit competition

is to outwork competition. A sure way to reap a bigger savings crop is to cultivate more intensively. A sure way to get bigger new business results is to work harder. Perhaps I may visualize something of the savings problem and the opportunity by reminding you that if bankers could add just \$50 to the average balance of each savings account, it would make the difference between profit and loss on thousands of accounts; taking the country as a whole, \$50 added to each savings account would increase savings balances by \$2,500,000,000. Moreover, we should add also from 2,000,000 to 3,000,000 new depositors every year. What we need is to visualize our new business and advertising opportunities more clearly, and certainly more hopefully. There must be a definite new business program, with responsibility definitely established and carried out.

A NEW BUSINESS PERSPECTIVE

I have said that the second essential for a young savings banker is a new business perspective. Specifically, what does a man bring to his work when he has a proper new business perspective? I have already indicated that he must have a new business program. He must ask himself: "How many customers should my department have this year, next year, year after next? How much business should each of these customers do with this department? Have I anything to sell which my competitor cannot quite equal? Would I, as a savings prospect, buy these particular services which I have to offer?" Too frequently, through poor salesmanship, we have placed ourselves on the defensive in using

3% or 4% interest as our sole talking point. A savings account as ready cash is an essential to the material success of any individual. Its benefits are as definite as those of life insurance. It has no equal for liquidity; it is safe, is immediately available, and never fluctuates. Have we not failed on many occasions to impress our customers with an appreciation of the value of ready cash, absolutely liquid, without lien or claim, a necessity to any individual who hopes to take advantage of his opportunities and overcome his difficulties? He is a poor saver indeed whose savings account, with the banker's counsel, does not actually earn many times 3% or 4% in independence, security, and peace of mind.

The savings banker is a physician, looking after the financial welfare and material health of men and women. He may feel at times that the consultation all day long with customers frequently deals with trivial matters and distracts him from the thinking he would like to do on the major policies of his department. But he has no more important service to render to his customers than to give sound counsel, the kind of financial advice which in the savings department goes far beyond finance and banking and deals with almost every human difficulty. He must of necessity be patient with a young man who is only beginning to accumulate money and who is sorely in need of the simplest analysis of his problems. He must likewise possess sufficient experience so that he can bring to the solution of the problems of those customers who have accumulated wealth the best of business judgment. The savings banker who approaches his selling problems with these qualities, and with

faith, enthusiasm, an appreciation of the romance in his day-by-day activities, loyalty to sound banking ideals, and vision which enables him to see his future as potentially great, will of necessity have a forward-looking new business program and a vigorously growing institution.

AN OPEN MIND

The third essential executive quality of a savings banker is an open mind—a mind not anchored to tradition so firmly that it fails to keep pace with progress.

Although the pressure of competition and freedom from the cloak of dignity have made for the more rapid development of every phase of savings banking, there is still a great need for young men and women who see clearly, think conclusively, and approach the savings business with an open mind. In many respects banking has not always kept pace with other lines of business, and it is only in recent years that it has stepped into a period of precision in knowledge and organization. I seek not to discourage, but rather to point out the opportunities for a young man with an open mind. There is before each one of us the opportunity of finding a new and better short cut in methods of operation where generations of bankers may have been following a circuitous path.

The history of American business progress is largely a record of the accomplishments of men who approach their responsibilities with an open mind. In advocating open-mindedness regarding our methods, procedure, policies, and operations, I would not have you believe that I am trying to minimize the importance

of experience, of time-tested rules, of great traditions in the banking business. No one holds the fine accomplishments of banking in preceding years in greater reverence than I, but, with due regard to the past, let us approach our problems with an inquisitive, critical, open mind, constantly seeking to improve. As the savings deposits of this country have grown, we have advanced to new responsibilities. There are many savings problems today which require that decisive reconsideration which only a man with an open mind can give. It is not enough merely to apply to these problems the experience of the past and what some one has called "the processes of antiquity."

How many times in urging that all employees make an attempt to secure new savings business have we heard such comments as the following: "I am so busy all day long, working from 8:30 a. m. to 5:00 p. m., that I haven't time to get new savings accounts"; "All my friends are already customers"; "I don't have an opportunity outside of business to meet new people who might become customers"; "If I were only a teller, I might be able to get new savings accounts." By and large, I wonder how many of those comments come from closed minds. One is reminded of the automobile salesman in a northern state who sold automobiles in the winter time. Some one asked him, "John, how do you sell cars in the winter?" He replied, "Aren't you supposed to sell them in the winter time?" His attitude is typical of those individuals and those businesses that do things because they don't know they can't be done. And so we find in many banks young men and women securing new business, working out new

plans, shortening methods, and improving the operation of their departments because they don't know that these things can't be done. Instead of merely following blindly policies and procedure laid down for us in the past, ought we not approach our daily work with an open mind and do some constructive thinking ourselves?

PERSISTENT APPLICATION

A savings banker may have all these qualities, but if he lacks the fourth essential, which is persistent application to the job, all else is of no avail. He may have knowledge and be able to base the management of his department on facts; he may have a genuine appreciation of the importance of new business; he may come to his work with a true understanding of the significance of an open mind. He may have all these qualities, and yet fail because of a lack of persistent application to the job.

Hard work, or persistency in keeping at the job, is an old fashioned quality; but it is, nevertheless, the keystone of all those qualities that help to build a good savings banker. It is so easy not to budge; it is so easy to go along without making any great effort; it is so easy to compromise or to give up when our purposes are thwarted; but to drive straight through to the practical application of our thoughts, persistently, day by day, is no easy task.

Savings banking needs more young men and women who simply will not stop work when the windows to their cages are closed at two or three o'clock. It needs more individuals who are willing to wrestle early and late with the great unsolved problems of the savings business.

Give any one the radius of a young man's willingness to work and to apply himself, and he can circumscribe that young man's future. How many young men are willing to follow a Thomas Edison, who worked nineteen and a half hours daily up to the time he was fifty-five years old, and eighteen hours after that, and who, it is said, labored at one time for five days and nights continuously, struggling to perfect an idea? What young man is willing to pay the price in the banking business of a Henry Ford in industry, who would work all day in the plant and then work at night in his own shop, striving to make his first automobile?

A young man, lacking the means to go to college, secured an appointment to West Point. He was poor, and handicapped in many ways, but he determined to excel by applying himself to the job. His room was so situated that at night he could look out and see the light burning in the window of another boy who was vying with him for scholastic honors. This young man studied every night until the light in the other student's room had gone out, and then he studied a little longer for good measure. He was determined to do as much and then a little more than his most industrious competitor. At the end of his career at West Point, he finished with high scholastic honors. How many young men are there in savings banking who are willing to work just a little longer than their most industrious associates? Many examples might be given of men in the banking business who have followed precisely this course. I commend a study of their lives and a persistent application to the job to every young man and woman in America.

In conclusion, may I repeat the four qualities which I have discussed, and which I firmly believe to be essential to success in savings banking:

1. Mastery of the facts
2. A new business perspective
3. An open mind
4. Persistent application to the job.

If each one of us will conscientiously shape his daily activities along these lines, I believe that in the next ten years we may witness accomplishments in savings banking which will far excel all of the fine achievements of the past.

Discussion

MR. CHAIRMAN: Mr. Marquardt uses an expression that appeals very strongly to me. He speaks of the twilight zone of authority. I think possibly the senior executive officers of our banks have more trouble drawing the line as to just what that twilight zone of authority is, between them and the junior officers, than in almost anything else.

That raises another question in my mind that I should like to ask Mr. Marquardt. Have you any practical plan in mind whereby the thinking, industrious, active young employee of our institutions might suggest constructive ideas and constructive thoughts, and yet not be a burden and a nuisance to the officer to whom he may carry those thoughts?

MR. MARQUARDT: Several industrial concerns that I know of and some banks are at the present time using the question box method. I will not go into the detail of the plan, for I think perhaps Mr. Kinsey has heard of it. Several boxes are placed in different departments in the

bank. The employee does not sign his name but he signs with a number. Each employee is given a number, and those suggestions are turned over to a committee of officers who determine their value. I know of two banks that now make a practice of paying their employees where these suggestions operate to decrease cost, and so on.

We like to feel in our organization at least that we are never too busy to talk to our employees about anything they may have on their minds. But to get away from all that detail (we do know it is sometimes overdone) I think the suggestion box is a splendid medium.

ARTHUR D. ANDERSON (United States National Bank, Omaha): If I understood rightly, you made the remark that some tellers handle a great many more transactions than others. Is that correct?

MR. MARQUARDT: It is.

MR. ANDERSON: For a moment I should like to turn this into a savings department. In our own department, for instance, our cages would extend down to the wall. Is it not natural for the customers to go to the first two windows rather than the last two?

MR. MARQUARDT: Quite natural. That is very easily taken care of by having an alert floor man or policeman on the floor. Very often, you find that your customers wish to go to certain tellers. If they do, that is all right. It is obvious that it would be foolish for five, six, or ten people to pile up in front of two or three windows when half a dozen tellers further on are not busy at all. It is simply a question in my mind of having an alert floor man on the job.

MR. ANDERSON: That is true.

In the personal end and savings bank end of our own particular bank we have a plan of starting our new tellers on the further stands, and the old tellers in the closer stands; that would mean that the experienced teller would handle more deposits than the new one even if we kept the customers further down.

MR. MARQUARDT: I think that is a good idea.

GEORGE W. WRIGHT (Bowery Savings Bank, New York): If I may answer that question further, I think the alphabetical unit would solve that problem.

MR. ANDERSON: We have used the alphabetical system, but for many reasons it has not been so satisfactory. For instance, there might be more people who would answer to the name of Anderson than to O'Brien.

MR. WRIGHT: Down in the Bowery office we have just put in the alphabetical unit. We kept away from it for years, because we believed we had more Cohens than Rosenbergs.

The strange part is that we did not find Cohen predominating at all. We found B one of our heaviest letters. We have six units; one of the units we purposely left light so that we could use that for odds and ends. I do not know of any system that answers the question of inequality better than the alphabetical unit.

MR. MARQUARDT: I think, Mr. Wright, it is largely an individual problem. I think perhaps certain situations and certain localities change that.

We have given that some thought in our institution of 200,000 accounts, and we feel, and feel strong-

ly, that the less you tie your customers down to any special window, the more easily you can get rid of them. The problem of the Bowery Bank in New York may be entirely different. I say I think that is something that requires individual study on the part of each bank.

THE CHAIRMAN: Has any one else a question?

I want to carry out one of Mr. Marquardt's thoughts, whether he made it directly in words or not, to the effect that one of the crying needs of the savings banks and the mutual savings banks, I may say, of the metropolitan district, is the lack of officer material. I am honest in that statement.

As I look over the field, there seems to be something lacking in the boys who decide to become bankers. It may be that in the commercial and industrial field, there is a different type of employee. Whether the boy in the savings bank particularly goes in with the idea of short hours and easy work, I do not know, but it is a very, very crying need, the lack of officer material.

I wonder whether it is general throughout the banking field, whether they have the same trouble in other banks, or whether commerce and industry, manufacturing concerns, get a different type boy from the ones we seem to be able to dig up.

DALE TUSSING (Security First National Bank, Los Angeles): Returning to the question box, it may be interesting to some to know that we have tried it in our bank in Los Angeles with very, very satisfactory results. It has a twofold purpose. It works out in this way: You find out who in your organization is really thinking; you find out who in your

organization is really trying to improve the service.

An example of a concrete case: We offered rewards for the three best suggestions made for improvement of the service. One was just an ordinary suggestion, but it had value; it was to type the answer on the back of an incoming letter, so that when you have the letter you have the reply on the reverse side. That does away with the pinning of the carbon copy, cuts down the files, and saves pins. In addition to that, and what to my mind is most important, you find out who in your organization is doing more than his day's work. He is thinking of what he can do to improve the service of the institution in which he is employed. In that way you get a good line on the men you have. Sometimes you will discover by the type of suggestions made and the number of them the material of your junior officers.

JOSEPH C. BOGGIO (First and American National Bank, Duluth): We had had the experience of having a question box in our office. As you say, it has brought satisfactory results, but we found that the maximum life of the box was about three to four months. There is a period of time to get the individuals to put suggestions into the question box. It seems that the ones who do the thinking hand in their questions, and then after the first month or two, the answers get very scarce; by the fifth or sixth month there are no answers going in. As a result of that, we have taken them out.

I do believe that if they were put in for two or three months every year, there would be a greater tendency for ideas to come up, and interest would not wear off.

Segregation of Funds

By J. HOWARD STEENSEN

ASSISTANT CASHIER OF THE CALIFORNIA BANK, LOS ANGELES, CALIFORNIA

Address before the Denver Departmental Conference

Mr. Steensen discusses the advantages of the segregation of savings funds in banks engaged in commercial banking activities. He presents the specific methods of segregation which have been used in California since the passage of the Bank Act of California in 1909; and the operating advantages of such segregation in connection with loaning facilities, volume of real estate loans, and earnings on reserves.

In discussing the advantages which this method offers to the public, Mr. Steensen quotes State Superintendent of Banks, Will C. Wood: "The savings depositor is usually the individual of small means with not much experience as an investor. He puts aside at intervals a part of his income to acquire a reserve fund. His concern is not so much the earning capacity of his savings, but the safety of the principal amounts. This is only to be accomplished through careful limitations of the investment of his savings by banks receiving them and by a segregation of assets. In California, owing to the restrictions placed on the use of savings and the insistence upon the departmental principle, the word 'savings' has become something of a trade mark. The effort has been to make savings equivalent to security."

BANKING, probably more than any other profession, is based on confidence; the very existence of banks is made possible by virtue of the confidence of the public in the safety of funds entrusted to their care. Sound confidence is built upon an experience of safety; safety justifies faith and trust.

In considering the topic, "Segregation of Funds," which was assigned to me, I assumed that it was the wish of the chairman that I should confine my discussion as far as possible to the advantages of the segregation of savings funds in banks and trust companies engaging in commercial banking or trust company activities, or both, in addition to doing a savings business.

With this in mind it shall be my aim to point out that the segregation

of funds under the departmental principle as embodied in the California Bank Act affords exceptional legal protection to savings depositors. This additional safety has made possible a remarkable record in California which fully justifies the confidence of the people in state banking institutions.

THE BANK ACT OF CALIFORNIA

In this connection permit me to quote the Honorable Will C. Wood, State Superintendent of Banks: "The confidence of the people of California in state banking institutions is not misplaced. The Bank Act which governs the state banks of California affords exceptional legal safeguards for savings depositors."

The Bank Act of California was passed in 1909 and Ira B. Cross,

Head of the Department of Economics of the University of California, in Berkeley, and a member of the Board of Regents of the American Institute of Banking, in Volume II of his work, "Financing an Empire; the History of Banking in California," says: "It may not be amiss to mention in passing that from July 1, 1909 to January 10, 1927 so far as is known there have been no losses to depositors in state savings banks."

Of course, no system is entirely infallible, especially if mismanagement or dishonesty enters into the situation. There are at the present time in California six state banks in the process of liquidation. In one case the savings depositors already have received 82½ cents on the dollar. In another case the liquidation was forced as a result of embezzlement by one of the officials. In two other cases the banks were suspended because of unwarranted loans to tenant farmers, while gross mismanagement was the cause of one of the most recent liquidations. Still another was the result of internal manipulation. However, in all of these cases it is quite possible that the savings depositors eventually will receive one hundred cents on the dollar. The record of California is truly remarkable and certainly justifies the confidence of the people in state banking institutions.

SEGREGATION OF FUNDS

Segregation of funds under the departmental principle of banking, although practiced in several states today, is perhaps most frequently associated with the California Bank Act of which it is one of the fundamental principles.

The consolidation of the separate fundamental kinds of banking in one corporation is not new and is practiced today in various commonwealths whose laws do not embody the departmental principle of banking. The distinctive feature of the departmental plan as outlined in the California Bank Act is that any one or two or all three types of banking recognized and defined by the law, namely, savings banking, commercial banking, and trust company activities, may be practiced by one corporation duly organized for that purpose, provided that the different departments and their respective assets are completely segregated.

The minimum amount of capital required for the different departments is set forth in the law and varies according to the population of the community in which the bank is to do business. If an institution is adequately capitalized and its articles of incorporation sufficiently broad, it has the fullest latitude to engage in all three kinds of banking, providing a permit based upon a finding of public convenience and advantage has been secured from the State Superintendent of Banks. No separate corporate entity for each type of banking activity is required, but the Bank Act makes the following provisions for the complete segregation within the corporation of the two or three different departments:

The capital and surplus of the various departments must be segregated and allocated to each respective department, subject to the approval of the Superintendent of Banks. After this allocation has been approved, it may not be disturbed except with the consent of the Superintendent of Banks. Re-segre-

gations have been allowed in many cases where the capital and surplus in one department were found to be more than sufficient for the business of that department and the business of another department was growing so fast that additional capital was required.

The capital and surplus separately allocated to the commercial and savings departments must be used as a basis for estimating the aggregate deposits which may be accepted in each department.

The investment of the capital and surplus separately set aside to the commercial and savings department is subject to the same rules that govern the investment of deposits by each such department.

The loaning limit to a borrower in either the commercial or savings department is based on the capital and surplus actually set aside to that respective department.

Reserves must be separately figured and separately maintained against the deposits of each department. The reserves required of a savings department are different from those required of a commercial department. No deposits may be made by the savings department with the commercial department or vice versa, although trust funds may be deposited by the trust department with the savings department or commercial department of the same institution.

Separate books of account for each department must be kept by a departmental bank and each department must be governed as to all deposits, reserves, investments, and transactions relating to that department, by the laws specifically provided for that respective department.

All departments of a departmental

bank must be conducted in one building or in adjoining buildings, except that with the previous written consent of the Superintendent of Banks, the business of the trust department may be conducted in a separate building within the same city if desired.

All cash, securities, and property belonging to each department must be kept separate and apart and not mingled with that of another department.

All money and assets belonging to each department, whether on hand or on deposit with other banks, and all investments by each department are to be held solely for the repayment of the depositors and other claimants of that department, until all depositors and other claimants of each such department shall have been fully paid. In other words, in the event of the necessary liquidation of a departmental bank, the assets of each department, under the law, must first be used to satisfy the claims against that department as a separate unit. Not until all of the claims against a particular department have been completely satisfied out of its assets, can any overplus of assets be applied in satisfying the demands of the creditors of another department.

When a called report is submitted to the Superintendent of Banks, each department of a departmental bank must render a separate report showing in detail its actual financial condition.

Hence if properly conducted within the spirit of the law, the commercial and savings departments of a departmental bank are separate institutions under one corporate entity.

ADVANTAGES IN OPERATION

From the standpoint of operating

advantages, the three important points to be considered are loaning facilities, volume of real estate loans, and earnings on reserves.

The legal loaning limits in the commercial and savings departments are different, and are based on the capital and surplus separately allocated to each department. Inasmuch as an individual or corporation may borrow the legal limit in each department at the same time, the segregation and apportionment of capital and surplus to the different departments of a departmental bank provide maximum loaning facilities to the individual borrower.

Let us take for example a California departmental bank with a capital structure of \$5,000,000, and assume that in the segregation of combined capital and surplus \$3,500,000 is allocated to the commercial department and \$1,500,000 to the savings department. The commercial department of such a bank could loan to one borrower 10% of its capital and surplus, or \$350,000, on an unsecured basis, and an additional 15%, or \$525,000, secured by a margin of 15% of the market value of the collateral, making a total direct loan of \$875,000 in the commercial department. It should also be noted in this connection that the security on which this additional 15% may be loaned may include stocks, bonds, or real estate, as well as staple commodities evidenced by warehouse receipts. Furthermore, the period for which such a secured loan may run is unlimited.

In addition to the loaning limitation in its commercial department, this California departmental bank could loan in its savings department 50% of its savings capital and surplus of

\$1,500,000, or \$750,000, to the same individual or corporation borrowing in the commercial department. This may be secured by real estate having a margin of 40% of the market value or by bonds and stocks approved by the Superintendent of Banks as legal investments for savings banks, having a margin of from 10% to 50% of the market value, depending upon the classification of the securities; government, state, county, municipal, and school bonds requiring a margin of only 10%; utilities and real estate bonds requiring a margin of 15%; and all other classes of bonds and preferred or common stocks requiring a 50% margin.

The experience of twenty-one years under the California Bank Act indicates that the loan limitations which it applies to departmental state banks are entirely safe.

There is no limitation on the amount of loanable funds which the savings department of a California departmental bank may invest in real estate loans, provided each loan does not exceed 60% of the appraised market value of the security. It has been found that an investment by a savings department of from 70% to 75% of all its loanable funds in conservatively appraised real estate mortgages is entirely safe; experience having shown that a 20% liquid secondary reserve in bonds, bankers acceptances, and high type of commercial paper, together with the 5% required by law, is ample.

RESERVE FUND

The 5% reserve against its savings deposits which a California departmental bank is required by law to maintain is segregated into the follow-

ing two classes: $2\frac{1}{2}\%$ may be carried with reserve depositories or invested in interest bearing obligations of the United States; the other $2\frac{1}{2}\%$ must be carried on hand either in bullion or other forms of authorized currency or deposited with the Federal Reserve bank, except, however, that no savings department, regardless of the amount of its deposits, is required to maintain a cash reserve on hand or on deposit with the Federal Reserve bank exceeding \$400,000. The remainder of this second $2\frac{1}{2}\%$ may be invested in United States Government bonds or deposited with reserve depositories. This gives the California departmental bank a material advantage in the way of earning capacity on the reserves required against its savings deposits.

For example, under the legal ratio required of capital and surplus to deposit liability, a savings capital and surplus of \$1,500,000 would maintain savings deposits of \$89,000,000 in a California departmental bank without branches, and a slightly lower ratio of deposits if the bank had branch offices. Assuming that such a bank was able to obtain \$50,000,000 in savings deposits, the required reserve on hand of $2\frac{1}{2}\%$ against such deposits would amount to \$1,250,000. However, only \$400,000 of this would have to be maintained on hand in cash, or on deposit with the Federal Reserve bank. The remainder of this $2\frac{1}{2}\%$, or \$850,000 could be deposited with reserve depositories to earn 2% , or invested in United States Government bonds to yield approximately $3\frac{1}{2}\%$.

There is a slight disadvantage to a departmental bank in the segregation of general ledger and control records, although, inasmuch as the

keeping of such records forms a very small part of a bank's bookkeeping problem, the bulk of which is in connection with the individual accounts where there is no duplication of records, the extra work entailed is very negligible. Furthermore, the law is flexible enough to permit the accumulation of all earnings and expenses in one department, through which all bills may be paid.

ADVANTAGES TO PUBLIC

The functions of commercial banks and savings banks are entirely separate and distinct. A commercial bank, as its name implies, finances the day to day banking needs of commercial and industrial enterprises. The chief function of such a bank is to finance the movement of commodities, not their production. A savings bank, on the other hand, finances enterprises in which time is the chief element. Its loans are more in the nature of a capital investment. The ultimate repayment of such loans is ordinarily derived from the returns on the investment rather than from the sale of the underlying security.

Savings deposits represent accumulations of capital in an interest bearing term account. Inasmuch as long time loans and investments of such funds must be made to provide for maximum income and continuity of investment, it is therefore important that such loans and investments be restricted to the highest type for safety of principal.

Theoretically, in this day and age of scientific bank management and comprehensive governmental examinations, all departments of a bank should be, and usually are, equally well managed, regardless of whether or not

there is a segregation of the different departments and their respective assets.

Actually, however, the lawmakers of California feel that the segregation of savings funds affords exceptional legal safeguards for savings depositors, for when savings funds are not segregated they must inevitably be mingled with commercial money and be subject to the credit hazards of commercial loans. The average savings depositor is primarily interested in safety and prefers to leave his investment problems to his banker.

Let me, in closing, again quote State Superintendent of Banks, Will C. Wood:

"The savings depositor is usually the individual of small means with not much experience as an investor. He puts aside at intervals a part of his income to acquire a reserve fund. His concern is not so much the earning capacity of his savings, but the safety of the principal amounts. This is only to be accomplished through careful limitations of the investment of his savings by banks receiving them and by a segregation of assets. In California, owing to the restrictions placed on the use of savings and the insistence upon the departmental principle, the word 'savings' has become something of a trade mark. The effort has been to make savings equivalent to security."

Discussion

GEORGE SCHRAFFENBERGER (Brighton Bank & Trust Company, Cincinnati): Are there very many building associations in your locality?

MR. STEENSEN: Yes, there are very many.

MR. SCHRAFFENBERGER: The idea came to me that if we advertised that the savings money is invested in mortgage loans on real

estate, would it not be a bigger play for the building associations to come right back at us with the statement that that is what they do and that they pay 5% and 5½% and 6% for their money whereas we pay only 3%, and that they are using the same wonderful security, real estate, for their main investment?

MR. STEENSEN: The building and loan proposition is rather a ticklish subject. Of course, in their advertising they make many statements which are misleading, but it is a fact that in California, for instance, our savings loans are restricted to 60% of a conservative appraisal, market value of the security, whereas the building and loan associations, I believe, loan as high as 75% and more.

As a practical matter, the banks in California ordinarily do not loan more than 40% of the appraised valuation of the property, and very seldom can you secure a loan from a savings bank of more than 50% of the appraised valuation of your property. Of course, the matter of reserve also enters into the discussion there. However, there are probably others better qualified to speak on the building and loan situation than I am.

MR. SCHRAFFENBERGER: The only question that comes up there would be the appraised valuation. My idea of the appraised value of a piece of property might be altogether different from yours. The building association's idea might be that the property is worth \$10,000, and ours might be that it is worth \$6,000. The appraised valuation is something by which we can guide ourselves, but it may not, of course, be the real valuation of the property.

MR. STEENSEN: That is true.

Of course the banks are very conservative in their appraisal of property. It is well known that the building and loan appraisals are a good deal more liberal than bank appraisals.

This is a question on which I should rather not say much without the opportunity of previous preparation and consideration.

THE CHAIRMAN: Did I understand you to say that the savings department in the departmental bank is not permitted to deposit any of its funds in the commercial department of the same bank?

MR. STEENSEN: Yes, sir, that is correct.

THE CHAIRMAN: How many states represented have the segregation law? Do you know what states outside of California have the segregation law?

MR. STEENSEN: I believe Massachusetts, Oregon, Maine, New Hampshire, and California are the only states which have the segregation of funds under the departmental principle.

FRED M. GOODWIN (Peoples Savings Bank, Providence, Rhode Island): I should like to know the different rates of interest paid to the depositors in the commercial and savings departments.

MR. STEENSEN: In California, that varies in different localities. Of course, it is governed to a large extent by the clearing house regulations in the separate communities. In Los Angeles, the rate of interest paid savings deposits is 4%. We also have what is known as a special savings account on which we pay 3% interest on the minimum balance for the full calendar month provided the balance is not less than \$1,000.

The rate of interest paid commer-

cial depositors is ordinarily 2%. While there is no clearing house rule in Los Angeles, it is customary among most of the larger banks to deduct \$1,000 balance before computing the 2% interest on commercial accounts.

THE CHAIRMAN: Is there any limit to the amount a depositor may deposit in the savings bank?

MR. STEENSEN: No, except that a savings department of a departmental bank may accept total deposits only in proportion to its capital and surplus separately allocated to it.

THE CHAIRMAN: There would be nothing to prevent a man from depositing \$100,000 in the savings department at 4%.

MR. STEENSEN: On the other hand, the amount which could be loaned to an individual is limited.

MR. SCHRAFFENBERGER: Tell us some of the drawbacks of the segregation principle.

MR. STEENSEN: The accounting I did mention. I do not know that you could call it a drawback particularly, but the fact that a non-departmental bank has no limitation to the amount of savings funds or commercial funds which it can loan to an individual borrower is one point. In other words, a non-departmental bank has considerably more latitude in its commercial loans than a departmental bank has, although I feel that is offset by the fact that the departmental bank can loan more to the individual borrower, loaning in both departments at the same time.

Of course there is nothing except the dictates of good banking practice to prevent a non-departmental bank from loaning all of its loanable savings funds on an unsecured commercial basis.

New Business Development and Advertising

By F. R. KERMAN

VICE PRESIDENT OF THE BANK OF ITALY NATIONAL TRUST & SAVINGS
ASSOCIATION, SAN FRANCISCO, CALIFORNIA

Address before the Denver Departmental Conference

Realizing the close relationship existing between new business development and advertising, Mr. Kerman believes, nevertheless, that the two are distinct functions and that they should be administered by entirely separate departments.

In his presentation of the subject of new business development, he discusses the tabulation of prospective customers, the assignment of leads, preliminary training for solicitors, stimulation of all employees into active participation in the program, and the supervision of new business development.

Mr. Kerman objects to starting a consideration of bank advertising with the query, "How much shall we spend?" We must first consider the objectives before us and the appropriate media for those specific aims. The matter of cost comes up as the final point.

Mr. Kerman is especially interested in future developments in financial advertising. "Advertising must be in the forefront of broader enterprise, for public education is essential to the acceptance and appreciation of the current trends in banking. While in years gone by, it was sufficient for the public to know about and use the specific services as those services became thoroughly established, here is a situation in which understanding must accompany progress."

COMPARATIVELY few years, as time is measured, have seen a vast change in the way to advancement in banking. Until our own generation, the avenue which led to larger responsibility, greater remuneration, and executive preferment was clearly defined and easy to select, albeit not a broad open thoroughfare. The young man who chose banking as a career, might follow one of two courses: He could start as a page or messenger and advance step by step, ultimately emerging as an expert in management and operation; or he could branch off along the route, and enter the field of credits, where by proper application

and reasonable attention to business he might normally expect to bud and bloom into a full-blown loaning officer.

Fortunately, that condition no longer obtains. Banks have changed, becoming veritable department stores of finance. And the men who guide their affairs have taken on something of the multiple complexion of the institutions with which they are associated. As a consequence of this development we find that many new roads lead to Rome. The channels of progress in banking are almost numberless. The way to the top has become plural. You know and so do I, many senior executives in large

metropolitan organizations, who have never stood inside a teller's cage; never kept a set of books; never traced a collection; never figured interest; never twirled a combination; never punched the keys of an adding machine. You know, and so do I, doctors, lawyers, merchants, engineers, editors, contractors, teachers, and manufacturers who have stepped aside from their customary pursuits, to enter banking, and have made good.

The new picture we see when we look at our banks is an evolutionary one. We might almost call it composite. It has been drawn as the result of economic change, and of changed competitive conditions. Banks have a new appreciation of their opportunities, and have recognized particularly their obligation to perform a more complete service for their customers, and for the communities in which they are located.

In the course of growing, it has become apparent that increased deposits, with an appropriate preservation of the ratio of invested capital, mark the standard by which the bank's capacity for service might best be measured. This has resulted in an emphasis upon what, for the purpose of this discussion, is called new business. We may understand, however, that the term means increased deposits from old sources as well as the acquisition of business previously undeveloped.

Each bank as it determines upon a program for business development discovers that the activity is one of major proportions. Very early in the proceedings the department, when so constituted, takes rank along with credits, investments, trust, and the others of senior grade. The work is highly specialized, requiring careful supervi-

sion, constant attention, and the direction of some one who is enthusiastic, resourceful, and energetic.

NEW BUSINESS DEVELOPMENT AND ADVERTISING NOT IDENTICAL

New business development and advertising are related subjects. They are not, however, identical. If possible the two should be administered by different people. In general it is a mistake to have advertising included as a division of the new business department, or vice versa. People who engage in work of this character should be, for the best results, resilient. They should be capable of recovering quickly and completely, from reverses. They must from the nature of their work be intimately familiar with public reaction to what they do. An arrangement which shares the responsibility, and fails to permit freedom for the two departments to act separately, is unfortunate. The new business department should be a complete, self-functioning unit, and so should advertising. The new business department should be free to take the credit for what it accomplishes without dividing laurels, and so should the advertising department.

Since it is desirable to treat the two departments as separate units, it is also desirable to discuss them separately. Suppose then we consider new business development.

As a generalization, it may be said with a fair degree of accuracy, that the success of any plan depends upon the state of mind of the organization. Building deposits is not a one man job. The entire personnel, and this does not omit directors or the president, must be keyed to the task in

hand. Cooperation is essential in all ranks.

Let that be our jumping off hypothesis, our assumption. We start with a group interested in seeing the business developed, and willing to help.

What is our first step?

EMPLOYEE COOPERATION

The start should include a thorough study of the field. This involves a tabulation of prospective customers, checked with the credit department if commercial accounts are involved, and a division into groups, classified on the basis of approach. In compiling this list everyone may be solicited for help. Frequently family relationships and business or social contacts will be discovered.

Next comes the assignment of leads. Not everyone can successfully solicit every account. There are some prospects who require special treatment; perhaps a member of the board of directors, or senior executive must make the call. Good judgment in this phase of the work is of paramount importance, and an improper plan may readily wreck an otherwise potentially sound program. Incidentally, it is apparent that uniform cooperation must be had throughout the organization.

When solicitors are used exclusively for new business, preliminary training courses should be instituted for the purpose of instruction. After the men are actually on the "firing line," there should be regular meetings, daily, weekly, or at some stated interval, for discussion of the problems encountered.

I do not intend to talk in any extended fashion on this aspect of the work, since there are comparatively

few banks, out of the 24,000 in the United States, with special groups of new business men; those institutions which are in a position to engage on a large scale, have specialists who know their jobs thoroughly, and any comment of mine would be entirely gratuitous.

It is with the average bank, depending for its business development upon the regular staff of employees, that we are chiefly concerned.

For the most part, this work is a part time job, with those particular employees who feel sufficiently interested to do anything about it: the tellers, the bookkeepers, the stenographers, the clerks, and the officers. Some of them have a natural new business complex. All they require is intelligent direction. Others are indifferent. If they are given a definite assignment, and checked up, they will produce. A third group is negative. Performance of the individuals cannot be counted on, unless there is a sufficient urge or inducement. Contests are often used to stimulate activity; but I do not believe in contests, except perhaps in some extraordinary circumstance. It seems to me there are other, and better, ways of securing results. Proper presentation of the new business attitude at the time of employment is highly desirable. All employees should appreciate that, other things being equal, the ones who help build the institution and insure its growth and progress, are marked for advancement ahead of the ones who are indifferent. A record may very properly be kept showing what each has done, and this record should be examined when promotions or salary increases are considered.

Results come from "back pounding," not back slapping. Repetition

(what you call follow up). It is not enough to give John Brown a prospect to be solicited. John Brown must be reminded and re-reminded of his responsibility.

Someone, obviously, must supervise new business activity. An officer, of senior rank, enjoying the confidence of the directors, and possessed of a forceful personality, is the best choice. Perhaps more than any other person in the bank, he must have the qualities of leadership. For unless he can command interest, respect, and cooperation from everyone, his job is almost hopeless.

I think one of the best ways to secure employee interest is through some form of profit sharing or profit participation. The individual who knows that his efforts to increase business will be tangibly rewarded, not necessarily on the basis of immediate remuneration, but for the long pull, will perform accordingly, and will receive suitable recognition.

COACHING ESSENTIAL

In the development of new business through employee cooperation, a great deal of coaching is essential. Staff meetings are excellent vehicles through which to keep interest alive. These can be scheduled to take place before or after hours, either with the entire staff, or by departments, depending upon the number and the available space. Meetings of this character should be of limited duration, fifteen to twenty minutes. Brief talks can be given, drives launched, problems threshed out and demonstration interviews arranged, using members of the group who are particularly capable.

From time to time, it is effective to undertake special projects. An anni-

versary may be celebrated, a new service inaugurated, or an event of community interest recognized, by attempting to reach some predetermined goal. It is worth noting that the experience of institutions using this method has been highly satisfactory.

The individual who is charged with the responsibility for new business development should not lose sight of the fact that in the average bank, the staff is not a group of professional salesmen. Sales methods must be modified to fit the condition, and a great deal of patience exercised in the basic training. At the same time, profitable lessons can be learned from the great commercial establishments of the country, and the same principles which they have followed will be found productive of results for the bank.

The new business tempo of any given organization will reflect the spirit, the degree of enthusiasm, and the personal interest of the men at the top. If the chairman of the board, the president, and other senior executives, will not step in and lend a hand, when they are asked, it is not likely that those farther down the line will show a different attitude. On the other hand, if the leaders will blaze the way, the task of creating a new business atmosphere throughout the institution, becomes a relatively simple matter.

NEW BUSINESS DEVELOPMENT AN OBLIGATION

If there are any trends in present day methods, I should say they indicate an increasing appreciation on the part of the banks, of the obligation to develop new business. The obligation, which is real enough, is twofold:

To the stockholders, who have a right to expect that the institution in which they have invested their money, will not overlook opportunities for profit; and to the customers, and the community, whose interest can be best served by a bank which through steady growth is diversifying the character of its resources, and increasing its capacity for usefulness.

Then, let me add: There is no patent formula for new business development. Your bank, or any other bank, can get its share, if the job is approached with the same thoughtful, conscientious attitude, which characterizes the direction of the credit department, the note department, and all the rest. Employees who solicit new business will strike an average: they will fail in some instances and succeed in others. As in the case of salesmen who move from one prospect to the next, there will be found a ratio of success to failure. To insure reasonably satisfactory records, assign enough calls to keep the average up, and to afford the stimulus which the knowledge of achievement gives.

ADVERTISING

Suppose, now, we look at advertising.

It has been said that every man can do two jobs: his own and advertising. Sometimes, in spite of what I know from experience, I am inclined to believe this is true. If you will make it read "bank advertising," I am ready to subscribe to the statement. I will say this: I have heard some interesting advertising theory expounded by bank executives, who prefaced their observations by saying, "Of course I don't know anything about advertising, but—"

In what we are to consider here, let us again think about the average bank. As a matter of fact, when we talk about advertising, it is always a good plan to have the average in mind. It rarely pays to advertise to the exception, either above or below the general group. Appeals directed to the common denominator will have enough "splash over" value to influence borderline cases.

I have detected a tendency on the part of those in many banks to start any discussion with, "How much shall we spend?" That strikes me as the wrong way to go about it. If you were building an engine, you would want to know what it was expected to do, before you decided on the horse power.

Before you need bother with the advertising appropriation, it is a good plan to decide first on the objective, how it is to be approached, and what may legitimately be looked for in the way of results. This involves a survey of the field, including a study of the competition, as well as your own strong points.

TYPE OF APPEAL

When you have reached a decision as to the direction in which you are headed, it is next in order to consider the type of appeal. Most banks can well do a certain amount of background advertising of an institutional nature. By that I mean the sort of advertising which gives the bank a readily recognizable character, which will identify it in the minds of the public. The historical idea has been widely used, but I rather feel it has been a little overdone. It is just possible that other elements might be profitably used.

ADVERTISE DEPARTMENTAL
FACILITIES

Departmental facilities always lend themselves to exploitation. Advertising which overlooks such obvious subjects as trust service, safe deposit, savings, and the mill run of what the bank has to offer, is just gnawing at the edges. Appeal for protection of an accumulated estate; for protection of securities, important documents, jewels and other valuables; for protection against want in old age; for protection from unsound investment, and so on. There is no doubt that this protective idea plays a major part in the construction of bank advertisements. As a matter of fact it is just the old scare appeal scrubbed up and given a new suit of clothes. But such material fits in well with the general program of development in the average bank, and it is probable that no institution ever went very far wrong in its use. The particular selection you make for your own bank, will depend upon what you have in mind, and the people you wish to reach. Personally I do not worry greatly over appeals. I know there are certain basic emotions, and whenever the advertising flows along a course which runs parallel to any of these, I doubt if it makes very much difference whether the emotion be love, hate, envy, jealousy, greed, fear or any of the others. If it strikes any one of them, it is almost sure to click. The thing to keep in mind is, that the advertisements are directed at people, and whatever influences people in the particular direction you want them influenced in, is the appeal for you to choose.

About this juncture, in the plan, the question of media is raised. Usu-

ally it is introduced in this way. Someone says, "Sure that's a good idea, but how are you going to put it in a letter?"

"A letter," you reply. "Who said anything about a letter? This is for outdoor bulletins. Big 24-sheets, all over town."

And there the problem of media is presented.

What are you to use—newspapers, periodicals, street cars, direct mail, screen advertising, specialties, painted bulletins, or something else?

In attempting to give you anything helpful on this subject of media, all I can tell you is the way I go about it. I do not know what systems other people use, and I make no pretense at covering up my embarrassment, when I say that I do not believe there is a model method. If my plan is of any use to you, you are welcome to it; here it is.

In my opinion, all advertising is good. Given the opportunity, I always believe I could make a better job of whatever is in hand, if I might use all the great variety of media available. But there always bobs up the inexorable law of diminishing returns, to say nothing of an equally inexorable auditing committee. In consequence, before I actually present my proposals, I modify them somewhat, giving due weight to the several factors of cost, potential returns, correlation, coverage, flexibility, and expediency.

Suppose we have a specific service to develop. I like to work it out at the start, with the assumption that I am going to be able to use all the money I want, have all the time I need, and cover an unlimited market. Then I begin to scale down. First, I check the extent of the market.

Where are the prospects for this? Is it universally desirable, and universally acceptable? Usually not; so this cuts into my original consideration, and incidentally gives me the market limits. If the people I want to reach are non-English-speaking, you will readily appreciate that I could not use the general daily papers efficiently. On the other hand, if I wanted to talk to an entire community, and if the message I had to deliver were of sufficient importance, I would naturally think first of that particular medium. Then, I move on to the question of time. Is this a "today only" subject, or will it be of equal interest next week or next month? The answer will help me pick out which channels will prove most productive. I am not apt to choose painted bulletins, if my story is good for 24 hours only. Last comes flexibility. Can the medium be twisted to make a suitable setting for what I want to say? Is it adaptable to the sort of copy and illustration I am using?

The answers to these various questions cannot always be found at once, and not infrequently the answers are wrong when I find them. However, I always pick myself up, smooth out the wrinkles, and try it again. But I am keeping the medium problem checked in the meanwhile, and am learning a great deal.

THE ADVERTISING BUDGET

The matter of cost comes up as the final point. While I may have done a splendid job, fixing the market limits, locating the prospects, and all the rest, if the potential profit is not sufficient to justify the expense, then I am simply wasting time and money.

But I prefer to let the translation of the plan into dollars and cents come up at the end of the procession, for in this way I am sure that I have first canvassed the possibilities completely, and that I have not let expense warp the initial course of my judgment.

At this point, I am willing to admit, the real fight starts. For when the ideal program is put into figures, I begin to discriminate. The instincts of the utilitarian and the idealist stage their annual "battle of the century." If I use this particular medium, my temperament may feel a bit more gratified, but it is going to cost an extra \$3,500 to do it, and there are not potential profits to warrant the added burden. If I use that particular vehicle of expression, I will have a more rounded campaign, but I cannot justify the \$2,000 it will shove into the budget.

Do I make myself clear on this point?

In budgeting the ideal program, every medium, newspapers, outdoor, street cars, and so forth, should be given a cash weight. Each classification should be compared with the others, and an estimate made of how results will be affected by the elimination or addition of the respective groups. The ultimate result is a lump sum figure of so many thousands of dollars, or whatever the amount may be.

The aggregate is what should be regarded as the appropriation, and it is that amount which should be presented for executive committee approval. No predetermined or arbitrary relationship exists between the budget and the bank's resources, deposits, or invested capital. After the figure is decided upon, it may be found to bear some definite ratio to

these things, but that, to my mind, is a circumstance purely accidental. Business is changing from month to month (in fact from day to day, if we were shrewd enough to detect it) and what may be regarded as standard at this particular moment, may readily be far out of line within a relatively short time. This is true, I think, with especial emphasis when we consider advertising, and the job which advertising is expected to perform.

The ultimate cost, the budget figure, is something which will be reached (and on an entirely satisfactory basis) as the result of conferences and discussions between the advertising manager and the executive committee or other constituted responsible body.

THE FUTURE OF FINANCIAL ADVERTISING

Then, since I believe it is usually somewhat stupid to talk of what has already been done, just as though we were people who lived in retrospect and were incapable of giving thought to the future, I should like to conclude with a brief reference to what is ahead in financial advertising.

The larger problems and newer fields that accompany the development of branch, group, and chain banking, are present to challenge the ingenuity of those who concern themselves with public relations. Our institutions are growing, extending the scope of their activities and approaching markets which hitherto did not exist. Where does advertising fit into the mosaic, and what can it do?

Advertising, it seems to me, must be in the forefront of this broader enterprise, for public education is

essential to the acceptance and appreciation of the current trends in banking. While in years gone by, it was sufficient for the public to know about, and use, the specific services as those services became thoroughly established, here is a situation in which understanding must accompany progress. The inventor may proceed single-handed in his workshop, developing the conception of his brain, while people scoff and criticize. In fact jibes and ridicule may even spur him on. But with our problem, which concerns intangibles and direct human reactions, we can ill afford to endure a misinterpretation of what is in contemplation, or a misconception of the plans which are being followed.

Advertising, of necessity, has a task of large proportions, hand-made to the specifications of those who want the opportunity. Frankly, I do not believe we could ask for a better chance to show our wares, or a more fortunate position in which to place the burden than on the accomplishments of advertising.

Discussion

WALTER T. JUDY (Kanawha Banking & Trust Company, Charleston, West Virginia): I should like to ask Mr. Kerman what his experience has been with savings campaigns put on by professional campaign companies, giving out some little trinket in the way of a patent bank, fountain pen, or some article of that kind as a means of starting the account.

MR. KERMAN: May I revert to the Yankee and ask you a question. How many employees do you have?

MR. JUDY: Twenty-three.

MR. KERMAN: What is the population in your community?

MR. JUDY: Fifty-nine thousand.

MR. KERMAN: Are those all tributary to your bank? Could all the 59,000 people conveniently use your institution? Are they nearby and is transportation such that they could get to your institution easily?

MR. JUDY: Yes.

MR. KERMAN: It would depend on whether or not the organization would be willing to put enough people in the field to cover that. Experience has been, in so far as I have been able to learn from those banks that have tried it—we have never tried it—very much this: The accounts secured run out of the banking period in six to nine months.

Apparently your new business is held on the basis of acquaintance, personal friendship, interest, and familiarity. They come in and open these accounts that are solicited by these special organizations to get some particular prize, a fountain pen, a pair of suspenders, or whatever it may be. When that article has lost its novelty or worn out, their interest in the institution is gone.

When I asked you the question, my thought was that if you had a sufficiently large group of employees, you could probably use them in their spare time in cooperation with your personnel department to get them to develop the new business as well as other organizations could do it for you; and the business would stick because the new customers would know somebody in the bank.

MR. JUDY: We have tried two campaigns in a period of six or eight years, and both of them have turned out much in the manner you have indicated. I was especially interested in that particular locality, and whether it worked out that way.

MR. KERMAN: I do not know. Mr. Marquardt might know of such a situation in Chicago.

ROY MARQUARDT (First Union Trust & Savings Bank, Chicago): Our institution feels very much as Mr. Kerman does. We have never employed specialty firms for that purpose and I do not think we ever will.

For a very short period of time when we opened our new building, we entered into an arrangement for the distribution of wallets, but that is a little beside the point. As Mr. Kerman has said, we feel that the business that comes to you through these professional business solicitors is largely courtesy accounts. They are with you a very short period of time and then are gone.

I should like to ask Mr. Kerman a question. You mentioned profit sharing for your employees for the production of business. Did you mean a compensation plan in payment for the business concerned, or did you mean profits earned?

MR. KERMAN: I really meant profits earned.

MR. MARQUARDT: Which do you think is preferable?

MR. KERMAN: That is a little hard to answer. If I go out and bring in an account of \$50 and the bank pays me 1% for that immediately, it is not very much. I go out and buy a few extra packages of cigarettes or a new shirt and forget about it. If I go out and bring in a \$500 account today and if next month I dig up another account, and in another month I do as well, and then at the end of a six months' period when the bank pays its dividend I receive a communication from the president either in the form of our employees' publication or a letter saying that as

a result of my effort and the effort of all the other people in the bank, our business has increased and our profits have grown and we are being given a cut in those profits we helped to build, it is a larger amount than I would have received as a commission on any particular account at one time. While I may not put it into words, it leaves in the back of my mind this thought: "It does pay to get new business. It helps me; it has helped build the bank. There have been added profits. It has kept the organization together, and I believe it is a good thing." I may not put that thought into words, but it will be in the back of my mind.

I am rather inclined to say that I think profit sharing is better than compensation, although I would not say that as an absolute fact.

HOLDEN NAFF (Industrial Savings Bank, Birmingham): May I ask the speaker what analysis he places on the benefit that comes to a bank through school savings.

About three years ago my institution took hold of the handling of school savings in the city of Birmingham, and the first year it cost us about \$15,000. It has cost us about \$10,000 a year since that time to operate. Those accounts have run up to about \$95,000 at their maximum peak. Of course the primary idea in the thing is advertising. I should like to get your opinion on that.

MR. KERMAN: That is a tough nut. In California the law requires instruction in thrift in the schools. That is part of the curriculum, and the banks in California have for many years engaged in school savings. We have been doing it for fifteen years and we have not made a profit out of it, but it does have, as you say,

advertising value. I think it has a little bit more than advertising value. I do not believe it is a benefit that will come in five years or ten years or perhaps even fifteen years. Maybe the next generation will get it. But it is giving to the youngsters an understanding of the place that the bank has in the community, whether it is your bank or my bank or Joe Bush's bank. I do not know that we can assign a dollars and cents value to it. If you please, it gives an aura of glory and splendor to the banker himself that he may not deserve, but it is appreciated.

MR. NAFF: That is our idea. We did not expect to get any tangible benefit from the proposition in less than ten years. That is the time period we outlined. We have about 36,000 accounts, and statistics from over the country make us feel that we have made a record down there.

NORBERT BOUVIER (Bank of America of California, San Francisco): What is your opinion about Christmas Club advertising?

MR. KERMAN: If you are willing to put the money into it and put the staff behind it, you can make it pay. Our Christmas Club accounts are profitable. This past year they cost us about nine cents apiece, including the cost of advertising, newspaper space, the purchase of supplies, and the extra clerk hire. On that basis, we figure that our Christmas Club for 1930 will be profitable.

MR. BOUVIER: Including the 1% you would have to pay?

MR. KERMAN: We do not use that plan. We have our own plan and it is profitable.

MR. MARQUARDT: In determining that profit, do you charge the rental, and so on, all the overhead?

MR. KERMAN: Yes, sir.

MR. MARQUARDT: That is where a great many banks differ, in my investigations.

MR. KERMAN: They tried to make our plan unprofitable. We ran about five years at a loss, and they kept loading all the charges they could think of. Each year we would think we were going to make a profit, and then they would stick on another charge. We even had part of the administration expense.

ARTHUR D. ANDERSON (United States National, Omaha): Do you pay interest on the accounts?

MR. KERMAN: Yes, 4%.

MR. ANDERSON: We have had quite a bit of action in our particular bank. We started out the first year with a few hundred accounts, due to a more or less careless campaign, but it has been very active during the last few years, particularly the year before last. Last year, without the effort of the previous year, we added a couple of thousand accounts.

MR. KERMAN: What is your lowest amount?

MR. ANDERSON: We started that off with the one cent increasing account, but we cut that out. The lowest thing we have now is a straight twenty-five cent a week account which is easier to carry than the one-dollar account, twenty-four, and so on. It is the lowest we have in the increasing and decreasing club.

MR. KERMAN: I doubt if you can ever make that profitable.

MR. ANDERSON: It seems to be necessary to have it to carry some of the accounts.

MR. KERMAN: I do not think it is. Of course, I do not know your community. At first we thought we could not get along without the

cheaper clubs and we dropped them. Then we thought we could not get along with amounts less than twenty-five cents, and, we dropped those. Then we dropped to the fifty cent account this year, and now we have nothing less than \$1. That is the smallest account we take in the Christmas Club, and we actually have more accounts than we had on the old basis. The largest number we had on the old basis was 140,000; and this year with nothing less than the one dollar account, we have 175,000.

MR. ANDERSON: One and two dollar a week accounts are the most popular. After you get them into that class, do they eventually go into the regular savings? Is it necessary to have a Christmas Club for that class of depositor? Won't they deposit one or two dollars anyway?

MR. KERMAN: If you do not have a Christmas Club, some will go to other banks.

MR. ANDERSON: That is probably the reason we have carried the few smaller accounts, to get the new business started.

GEORGE SCHRAFFENBERGER (Brighton Bank & Trust Company, Cincinnati): How do you know your Christmas Club is going to be profitable? How could we determine that, when in one of our Christmas savings departments in one of our small banks more than half of the accounts are behind on account of the unsettled conditions? It costs money to carry them just the same even if they are going to make their deposits. How do you figure it is going to be profitable at the end of the year?

MR. KERMAN: We know from past years of experience that there are certain percentage drops. You have

me off guard. I cannot tell you what the percentage is. Out of the twenty-five cent class, perhaps 15% do not finish. Out of the fifteen cent group, 10% do not finish; and out of the one dollar group, a certain percentage drops out. We have automatically eliminated those figures, and in spite of that, we still make a profit. Whether conditions this year will affect those percentages, I do not know. I think they will still fall. I do not think our calculations will be more than 1% out; perhaps not more than $\frac{1}{2}\%$.

J. HOWARD STEENSEN (California Bank, Los Angeles): As I understand the Christmas Club, unless the deposits are made when due, no interest is paid, and the net rate of interest which I figure on the total Christmas Club accounts is less than the actual rate of interest paid on account of the mortality rate of those who do not make their payments.

MR. KERMAN: That is true.

LEO E. McLAUGHLIN (Butler County National Bank, Butler, Pennsylvania): I should like to ask Mr. Kerman if he thinks he could eliminate the payment of interest on Christmas Club accounts and still have a sizable club.

MR. KERMAN: I think so. There are twenty-three reasons why people save money, and the twenty-third is to get the interest. So you would lose on that basis less than 4% of your business if you did not pay any interest.

FRED M. GOODWIN (Peoples Savings Bank, Providence, R. I.): I should like to get Mr. Kerman's opinion on the advisability of the bank's spending, say, \$10,000 for advertising for a year. Would you spend that much anyway and carry

out that plan under all circumstances, under prosperity or under adversity? Isn't that somewhat like the man who goes on a vacation for three months of the year and fails to cancel his newspaper, and at the end of the three months comes back and has to pay for all those issues?

In our section of the country right now adversity in manufacture is quite prevalent, and practically no saving is going on at all. Yet our advertising program still continues. It seems to me that is a waste of money.

MR. KERMAN: I think people go right on advertising whether there is adversity or whether there is not. People may not save this summer or next September or next October, but the effect of advertising is cumulative.

I like your original statement of the proposition except that I do not think you ought to say \$10,000 for one year's appropriation. You ought to go into it with the definite commitment that you are going to do it for five years irrespective of conditions, whether good or bad; that you are going to spend whatever the amount is for a period of five years. You will not get the effect of it this year or in 1931. You may not get it even in your five years.

At a time such as this when there is a general let-down on the part of so many organizations in their advertising and in their new business efforts, and they say, "Times are hard; we can't get the business anyway," that is the time you can make the most effective impression. Think of the splendid position you would have been in if you had been saving your money last year, the year before, and the year before that. You have a wonderful opportunity during periods of

depression to register the name and personality of your institution, the time when competition is less than it has been in the past and less than it will be for some time to come. I believe you will get more for what you spend now than at any other period.

MR. ANDERSON: I notice nothing has been said about the value of radio in advertising. Have you anything to say on that?

MR. KERMAN: Yes. I understand Amos 'n' Andy are going to start broadcasting Postum, General Foods, or something like that. Some druggist said people came in asking for Amos 'n' Andy toothpaste; they didn't know the name of it.

If radio has been omitted in anything I have said here today it certainly has been unintentional. I thought I spoke at some point or other of every medium there was.

Radio has a very definite place in advertising. I do not believe that in banking we have got the most out of it. I do not think we have measured up to the opportunities in radio. That is probably because of the fact that for the average bank, radio is not a medium that is available. Take these 20,900 banks in towns of less than 10,000 population; they have no radio stations they can use. There are less than 4,000 banks in the United States that are located in communities where there are broadcasting stations, but the ones in those communities certainly can use radio.

I notice on the program that Paul Whiteman is to speak at some section here from Station KPO at San Francisco.

We have used radio, and when we have used it properly we have achieved excellent results. We have been on the wrong track once or twice.

We tried broadcasting the New Year's football game at Pasadena. I do not think it did any good.

Radio is a definite medium and it has a real value for the bank that can use it, and that will put intelligence into the construction of the program.

MR. ANDERSON: We have been using radio in Omaha for some time, probably four or five minute talks going on every night. The time varies during the day. It is usually in the evening around dinner time, or later on during the evening—not later than ten o'clock—that we go on for about five minutes. Most of our programs are based on historical facts.

MR. KERMAN: I think that is overdone. Are you getting results?

MR. ANDERSON: I cannot tell. I do not know whether to renew the contract on that or not.

MR. MARQUARDT: Don't you think radio advertising is too general? What is the use of the banks in Chicago advertising on the radio a message that will carry over the greater part of the United States? Nobody out of the city of Chicago is going to carry an account with us; at least very few of them will. It seems to us it is largely wasted effort. Maybe we are wrong.

MR. KERMAN: Very true. Most banks cannot use radio profitably.

MR. MARQUARDT: As a general proposition for thrift in banking, yes.

MR. KERMAN: It is pretty hard to do.

STEPHEN G. ELDRED (The Savings Bank of Utica, Utica, New York): I think Mr. Kinsey can give this audience some light on that subject. The mutual savings banks of the East went into combined advertising over the radio for one year on the subject of thrift, and I think Mr.

Kinsey was on the committee that got that started. He might tell us something.

THE CHAIRMAN: I do not know that I can give you any definite information on it.

The mutual savings banks of the Eastern states did for six months, I think it was, run a broadcasting campaign primarily on the subject of thrift, with no specific bank's name mentioned. The 150 banks of New York, and the banks of the New England states which covered 300 or more mutual savings banks, broadcast a mutual savings hour, so that it would be very hard, indeed, for any of us to determine definitely just what advantage it did have.

I quite agree with Mr. Kerman that in a group proposition such as that, with the proper program at the proper time, something might be accomplished. It is very hard in New York to get the time that is best suited for us, and the best station. These contracts with the broadcasting stations are made so far in advance that the time is sewed up by the time you work up enthusiasm among bank men; they will tell you that it will be three years and a half before they can give you a very definite time at a very definite station. It may be that with the coming of more stations—whether they are going to come or not, I do not know—something may develop.

DONALD SWARTHOUT (Grand Rapids National Bank, Grand Rapids, Michigan): Mr. Kerman, can you give us some of your sources for getting together a list of prospects in the new business department?

MR. KERMAN: In how large a city?

MR. SWARTHOUT: One hundred seventy thousand.

MR. KERMAN: You have a Chamber of Commerce?

MR. SWARTHOUT: Yes.

MR. KERMAN: Can you get lists from them? Can you use the hotels?

MR. SWARTHOUT: I do not believe the bank has ever attempted to get a list that we can use for that purpose.

MR. KERMAN: Do you have branches?

MR. SWARTHOUT: We have nine branches.

MR. KERMAN: We started our list by putting two men on the street whose job it was simply to go out and take names and addresses in geographical sequence. For instance, they would go down Erie Street and take down the names and addresses there. We could not depend on directories because they are too much out of date. A directory is at least one year old by the time they get it out.

There are some agencies that specialize in supplying lists. They are not exclusive. Anybody can get those. You can buy those from almost any direct mail agency. It is a good basis to start with. You probably have some in your city that are in position to supply you with a list of the people in your community who own automobiles that cost over \$1500, a list of school teachers, a list of lawyers, and that is a fine list to use, too. You can get various classifications from these different agencies. Of course, you can make them up yourself but it takes a great deal of time, and you can buy them cheaper than you can make them up.

FOREST BURCHFIELD (Grand Rapids National Bank, Grand Rapids, Mich.): Mr. Swarthout and I are particularly interested in branch

banking business. In Grand Rapids there are about thirty-five or thirty-six branch banks.

In what way would you advertise branch offices? Do you train your employees in the community or contact work? How would you advertise? Would you use your community papers, and so forth?

MR. KERMAN: We do not use community papers.

MR. BURCHFIELD: How do you begin a community contact plan?

MR. KERMAN: We require the people working in the banks to live in the community in which the branch is located. The manager of the Parkside branch lives in Parkside. The manager or assistant manager must become active. We feel it is desirable that he should be active in community clubs, community development associations, and preferably that he should become an officer of those associations, and sit in on the board of directors. Then the staff goes out and solicits new business from door to door; I mean from store to store. They do not make any house-to-house solicitation.

MR. BURCHFIELD: Is there any unusual service that the branches offer that the down town offices do not offer in the way of service to the individual members of the community?

MR. KERMAN: I do not think so.

MR. BURCHFIELD: No distinction there?

MR. KERMAN: No. They have safe deposits. Of course, the convenience of the community is there, yes.

MR. BURCHFIELD: We think we have gone as far as we can in the matter of service. Possibly we have gone too far. We have encouraged the payment of all telephone, gas, light, and water bills in the branch.

MR. KERMAN: People at the Security First National in Los Angeles can probably tell you a great deal about branch business development. We have used it a little bit differently. We do not do anything for branches in the way of business development that we do not do for the head office. The program we follow is identical throughout. We say our little branch out in the Sunset District is just as much an institution as the branch down on Market Street.

MR. BURCHFIELD: How are the locations selected for branches?

MR. KERMAN: Each branch location has a file about three inches thick containing reports, special surveys, and checkings that run back over a period of years; it covers the trend of real estate values in that community, the direction of population, its growth, and the number of new residents that have come in; we check the traffic at strategic points in the district. It is quite a job.

DALE M. TUSSING (Security First National Bank of Los Angeles): In answer to the question of what services you can give in a particular locality, we find that the safety deposit service is a very attractive one. For people who have to go down town to deposit their diamonds or get their silverware, it is quite an inducement to be able to drop around the corner.

In establishing a new branch, we do use the community papers, and at the opening we put on a regular party, not the kind you have on trains but the kind that people of the community will attend, with music and light refreshments. The branch officers are present and are introduced to everybody who comes in. The whole idea, purpose, and intention is to make

them feel that that particular bank is their bank, part of their community. As Mr. Kerman has well said, it is a very good idea, in our judgment, to have the officers and employees reside in that particular district.

We make a circle including a given number of miles; everybody in that circle is actually contacted by the employees who know them, if any do; if they do not, those best equipped to meet them make the contact.

You spoke of mailing lists. I do not know whether you live in a county seat or not, but suppose you had a lot of money to put out in real estate loans. Your assessment list would be very valuable to you. Suppose you are putting on a service in the trust department, something like an insurance, something special, something new to interest particularly wealthy people. You know the section of your community populated by the wealthy people. It is very easy to look them up in the telephone directory and get the names and addresses, recognizing their location by the address. There are a number of ways that can be done. As Mr. Kerman said, these paid lists are oftentimes very good.

MR. SCHRAFFENBERGER: We made a new list a couple of weeks ago. There is a paper published in Cincinnati that gives the new water meters every day, and we look through that daily to find out who has a water meter in our locality. First, the newcomer receives a letter inviting him to come to the bank, and so on. We found that very successful, and it is a good list, right up to date.

MR. KERMAN: Gas connections and telephones?

MR. SCHRAFFENBERGER: We

cannot get the gas connections and telephones. I think we could get the water meter information at the City Hall, but why go to the City Hall when it comes to the office every day and you can check it over?

There is a certain bank in our locality which absolutely will not hire an employee for a branch, manager or any one else, who lives in the community in which the branch is located. They say there is always a fear that some one in the community will drop something concerning what Mr. So-and-so is doing, that he has this or that in the bank. The employee may stop in the corner drug store and may say something about the neighbors which may become the gossip of the community. Therefore, no employee of a branch bank lives in the particular community in which the branch is situated.

MR. BOUVIER: Have you any suggestion to make in regard to the small savings and deposit accounts that have not been used for quite a few years? These savings accounts were obtained through small banks, and we have never seen the customers since.

MR. KERMAN: Forget about that.

MRS. M. E. BONHAM (Security Savings Bank of Riverside, Riverside, California): We have been trying to decide what to do with school savings accounts that we have had for about five years, accounts under one dollar.

MR. KERMAN: Are the people still in school?

MRS. BONHAM: We do not think so. We have not been able to locate them. Can we charge those off?

MR. KERMAN: What are you, a state bank?

MRS. BONHAM: A state bank.

MR. KERMAN: You have to advertise.

MRS. BONHAM: Not under ten dollars.

MR. KERMAN: Charge them off in service.

MRS. BONHAM: We would have to pass a rule, then, that we would have a service charge on savings accounts.

MR. SCHRAFFENBERGER: Don't you think the state law has something to do with it?

MRS. BONHAM: I have been trying to find out what to do with those.

J. HOWARD STEENSEN (California Bank, Los Angeles): We have a printed rule in our pass books, regular savings as well as school savings, which reads that the account is subject to the by-laws, rules, and regulations as printed in the pass book, and to the rules of the bank govern-

ing such accounts. Therefore, all that is necessary is to have a rule which provides that at the expiration of a certain time the account shall cease to draw interest and shall be subject to a service charge. In such a manner, at the end of ten years, for example, the school savings account would cease to draw interest. In fact, some banks have an arbitrary rule that they pay no interest on accounts under one dollar. At the end of ten years you could service charge the account fifty cents or one dollar and wipe it out.

MR. BOUVIER: Under ten dollars you can charge them off?

MR. STEENSEN: There would be no distinction as to the amount if you had a rule that the account, after it had been dormant for a certain period of years, would be subject to the service charge.

Unit System and Machines

By H. R. SMITH

ASSISTANT CASHIER OF THE BANK OF ITALY NATIONAL TRUST & SAVINGS
ASSOCIATION, SAN FRANCISCO, CALIFORNIA

Address before the Denver Departmental Conference

Mr. Smith discusses the economies made possible by the introduction of savings machines. He explains in detail the various operations performed by a single machine. The transition period does, of course, mean some difficulty, but Mr. Smith's bank worked out a method which minimized the amount of extra work involved.

The first severe test of window service with the machine was the first interest period. The machines proved to be even more efficient than was expected.

Mr. Smith mentions the changes in accounting brought about by this innovation, and summarizes the advantages of the machine in these words: "The installation of the machines was a practical and economical move from many standpoints. We were able to reduce the staff from twenty-four to eighteen, or by exactly the number of bookkeepers. The salary of these six bookkeepers alone paid for the machines in two years. In addition to the reduction in staff, we saved 162 square feet of valuable floor space and three windows. We secured a much neater passbook and ledger card."

DURING the past fifteen years a great many savings banks and savings departments have abandoned the old method of having separate sets of tellers for paying and receiving. There have been a great many discussions concerning the relative merits and demerits of the two systems, and it is my feeling that nothing would be gained at this time by entering into any lengthy treatment of the subject. It has been dealt with in these Departmental Conferences before, and most of the arguments on both sides have been brought out into the open. The subject which has been assigned to me was placed in the program, as I understand it, because of a rather widespread interest, at this time, in the operation of a savings bank or department with machines

designed especially for this work. One such machine is already on the market and is in use in quite a number of banks and instalment houses. It has been found that the use of these machines in a unit system makes possible a number of economies. While it is physically possible to use these machines without the adoption of the unit system, it is my opinion that such use would not result in as great a saving as is possible when it is used in a unit system.

HOW THE MACHINE WORKS

When set up for use in a savings department, the machine will pick up the old balance, post deposits, withdrawals, interest credits, duplicate deposit tag entries, corrections, and so

forth, to both the passbook and the ledger in a single operation, and show the new balance. At the same time, it registers the entire transaction on a wide tape which gives a permanent record of all that goes through the machine. The machine has a set of keys similar to the most common type of adding machine. The segregation of the various kinds of transactions and the determining of the position in which the entries print is done by the use of separate sets of keys. There are two such sets, so that the machine may be used by two tellers throughout the day. The machine accumulates the entries made in the various segregations, and the old balances picked up, and gives separate totals for each teller for each type of transaction at the end of the day, thus providing a convenient and accurate method of balancing the entire day's work.

To give you the benefit of our experience with these machines, I think it would be best to tell the story from the beginning. At the time we decided to install these machines, we had in our savings department a little over 35,000 accounts which we were handling with a staff of twenty-four men. This staff consisted of a department head, a chief teller, eleven tellers, a head bookkeeper, six bookkeepers and four junior clerks. The ledgers were in card form and postings were made on three commercial bookkeeping machines.

INSTALLING THE SAVINGS MACHINES

The savings machine requires a special type of ledger card and passbook. The horizontal lines on both forms bear corresponding numbers so

that an entry will appear on the same relative line in both passbook and ledger card. We had the cards and passbooks printed, and contracted with an outside concern to transcribe the names from our old ledger cards to the new cards and the new books. Since the numbers on the new cards and books ran consecutively, whereas there were gaps in the account numbers of the existing ledger, due to accounts having closed, we had either to throw away a lot of the new cards and books, or else assign all the accounts new numbers to correspond with the new cards. We decided on the latter course. The new numbers were typed on the old signature cards and on the old ledger cards, and the old numbers were typed in an inconspicuous place on the new cards, for cross reference.

In the meantime, one of the machines was brought into the bank, and all of the men who were to act as tellers were given a course of instruction on the machine.

THE TRANSITION

April 2, 1928 was set as the time for the switch from the old system to the new. On the preceding week end, the entire staff, augmented by men from other departments, ran all the old ledger cards, balanced them to the controls, transferred the balances to the new cards in pen and ink, and ran and balanced the new cards. The new cards were then placed in the trays, approximately 1000 cards to the tray. Although each unit can handle ten full trays with ease, we left a few trays empty in each unit to allow for expansion. This gave us four units with a little over 8,000 accounts in each unit, and

one with 3000. We placed a ledger cabinet containing the trays immediately to the rear of each pair of tellers' windows, a machine between the pair, and a man at each window. In this way we had one machine, two men, and about 8,000 accounts to the unit. We had six machines, one for each unit and one for the new accounts department. In order to make the signature cards accessible, we dissected our signature card file cabinets, and fastened a nest of fourteen drawers on the top and to the rear of each of the ledger cabinets by means of angle iron supports. The new passbooks for each unit were filed numerically in cabinets and the cabinets placed where they could be reached conveniently by the tellers. We placed the old ledger cards in temporary wooden trays underneath the ledger cabinets. With this arrangement, it was possible for a teller to turn and, with no more than one step, have available the new passbook, ledger card, signature card, and the old ledger card if comparison should prove necessary as it often did during the time we were exchanging the old books for the new.

On the opening day and for two weeks thereafter, we put an extra man in each unit to assist the tellers in making the exchange of passbooks. As a customer would come in, and present his old passbook, the teller would locate the ledger card, by means of the old number which was typed on it, and compare the balances, referring to the old ledger card when necessary. Then by referring to the new number on the new ledger card, he located the new passbook, posted the deposit or withdrawal and delivered the new passbook to the customer together with a small circular

explaining briefly what the new installation would mean to the depositor in speed, neatness, accuracy, and so forth. Naturally the window work was a little slow during the first few weeks until the tellers developed more speed and until the bulk of the new passbooks had been exchanged for the old ones. The machine in the new accounts department was used to make the initial entry in the passbooks and ledger cards of new depositors. These new accounts were spread around through the units to fill up the boxes which had been left empty. By the time these were filled, enough of the accounts in the other controls had closed to give a list of available numbers to assign new depositors. In this way each unit has its own share of the new and the old customers, and the activity is more evenly divided.

THE FIRST INTEREST PERIOD A TEST

The first interest period, which was July first, came just three months after the installation and we were wondering how it would turn out. Interest was figured as usual and was posted to the ledger cards by the machines. Although this assures accuracy and neatness on the ledger cards, we found that it took too much time to run all the cards through the six machines we had available. Ever since that first period, we have posted and extended the interest on the ledger cards in ink. It is faster, obviously, to have twenty-five men posting and extending in ink, than to have six men running them through the machines. When the passbook is presented, the interest is entered in the book with the machine, no entry being made on the ledger.

We felt that our first severe test of window service would be the usual rush of people who want their interest entered in their passbooks. There were still a great many of the old passbooks outstanding and we knew that many of them would be presented during this interest period. We entered the interest on the machine in all of the uncalled-for new books before the end of June so that the exchange of old for new passbooks would not delay the lines at the regular windows; we opened up a separate window at which we held all of these uncalled-for new passbooks. The floormen were instructed to keep their eyes open for depositors with old passbooks and to steer them to this special window for their new book. Then if the depositor wished to make a deposit or withdrawal, he was to go to his regular window. We stationed extra men behind the tellers as at first, and put a few others in the lobby to keep things moving. We found to our astonishment that the lines at the windows were not as long as at previous periods. We at first thought that this must have been a light period, but a check up of the number of entries made for this period as compared with previous periods showed that we had actually handled more than ever before. From then on, we never worried about the volume of counter business. We felt confident of anything.

After about six months, we asked each one of the tellers to write a letter telling whether or not he liked the new system, and without exception they expressed the feeling that it was a vast improvement. Before we installed the new machines, we took for granted that the operation of taking in a deposit or paying a withdrawal

would be a little slower with the machine because of the fact that the teller has to locate the ledger card on a deposit transaction as well as on a withdrawal. We felt that this disadvantage would be overcome in the improved appearance of the passbook and the sense of accuracy that the machine gives the customer as well as the saving in bookkeeping work. We were pleasantly surprised to find that with the machine the service was just as fast and if anything, it was faster. We timed some of the tellers during busy periods and found that it took just thirty seconds to handle a complete transaction, including locating the ledger card, comparing the signature in the case of a withdrawal and running the transaction through the machine.

ACCOUNTING METHODS

Now as to the accounting methods used with the new machine. As I mentioned before, our savings department is operated along unit lines. To obtain the greatest benefit from the unit system, it is necessary to educate your customers to a point where they will go to a window in the unit in which their account is carried. We placed signs at each unit giving the numbers of the accounts which could be served there, both the old numbers and the new. There are times however when one unit will be crowded and another will be idle, and nothing displeases a customer like being asked to wait in a line at his own window while the next window is empty. To overcome this we instructed our floor men that in an emergency, customers could be switched between the first and second units and between the third and fourth. The fifth unit,

which, as you will recall, has the fewest accounts, is made up chiefly of group accounts from the navy and various industrial concerns, and the window work is very spasmodic although the machine is kept busy all the time posting the entries that come in by mail and from our collectors. The problem was to get the figures from the machines to the general books and to the controls with the least red tape.

CONTROLS

Each tray of 1,000 cards constitutes a control and there were about eight controls in each unit, except the fifth. Just above the machines, we placed a small sorting bin with twelve pigeon holes. Ten of the holes were labeled with the numbers of the controls in the unit. The other two bins were marked "miscellaneous." As a transaction is completed, the teller, instead of returning the ledger card to the tray from which he removed it, places it in the proper pigeon hole in the bin, thus keeping them sorted by controls. When a customer from another unit is forced to come to a teller's window, the teller gets the ledger card from the cabinet of the proper unit, runs the transaction through his own machine and places the card in the "miscellaneous" bin.

Debits or credits which originate in other departments of the bank may be handled in one of several different ways. The method to be used should be determined by the volume of such transactions. The simplest way we have found is to have the originating department offset its part of the transaction with a "teller's exchange" and forward the savings debit or credit to the proper savings teller with

the other half of the "teller's exchange." It is then handled by the savings teller in the same manner as though it were presented by a customer.

During the day, the deposits, and the checks deposited, and the withdrawals are run in batches or blocks and the checks are sent to the clearing and transit departments for collection. The deposits and withdrawals are placed in a large basket until the end of the day.

At the end of the day's business, the totals in the machines are printed on the "take-off sheet" and the audit tape in the machine. This tape, by the way, is visible to the teller, but accessible only to the officer-in-charge who has the key. The tape bears a record of everything that has gone through the machine. It shows the account number, the symbol of the teller who made the entry, the old balance, and so forth. There is a separate total for each teller in the deposits, and withdrawals. The tellers balance their respective totals as shown by the tape and "take-off sheet" against the recapitulation of the batches or the blotter as we call it. This proves that every transaction that has gone through the machine, and which therefore could possibly have been in a passbook, is supported by the entry. A register made by recapitulating the "take-off sheets" is used by the general bookkeeper in posting to the general ledger control account.

As soon as the figures have been taken from the machine, one of the tellers in each unit re-opens, as of the next business day, for after hour service. The other teller removes the ledger cards which have been placed in the sorting bins during the day,

and lists the old and the new balances, taking a separate total at the end of each control. The "miscellaneous" cards, which, as you will recall, are the cards which have come from other units, must be sorted according to controls before they are run. The cards for his own unit are of course sorted as they are placed in the bins.

THE TELLER'S BALANCES

From a recapitulation of the old balances and the new balances of all cards handled, the teller can further prove his work in two ways: First, the difference between the old and the new balances of all cards handled should equal the difference between the total debits and the total credits posted during the day, as shown by the blotters of the two tellers in the unit; second, the listing of the old balances from the cards, should balance with the total of old balances as shown by the tape and the "take-off sheet" from the machine. The old balance picked up does not show on either the book or the card, but it does show on the tape, which serves as a means of check in case of a difference.

When the teller has balanced his totals of deposits and withdrawals to the blotter and when he has balanced the old balances as shown by the ledger cards with the old balances as shown by the total in the machine, and when he has balanced the difference between the old and new balances with the difference between the deposits and withdrawals, he is reasonably sure that everything is okeh and can re-file the ledger cards, and spend the rest of the time doing odd jobs.

The controls are run on a commercial bookkeeping machine, on sheets that are the same size as a commercial ledger page. In order to avoid the re-listing of all the deposits and withdrawals by controls for control purposes, the controls are made up from the runs of the old and new balances. For each control there will usually be two sets of old and new balances: one from the unit in which the control is located; and the other from the next unit, arising from the handling of overflow customers. There will also be some work from the new accounts department. The control clerk picks up the balance in the control as of the previous day, subtracts the old balance from the runs of both units, adds the new balances from the same runs and, if any, from the new accounts department, and takes a total. After he has gone through this operation for all of the controls, he determines the total for each unit, and the total of all units. In order to prove the accuracy of his work, he then prepares the master control. To do this he picks up the total for all units as of the preceding day, subtracts the total of withdrawals and adds the total deposits as shown by the blotter plus the work of the new accounts department. If this balances with the total of the individual controls, it is a proof that the controls are correct.

CORRECTION OF ERRORS

That explains briefly the procedure in the ordinary course of business. The question now arises in your mind, quite naturally, "What happens when somebody makes a mistake?" Well, as many different things can happen as there are different kinds of mis-

takes. In general however, the adjustment of mistakes is not a difficult task. If the error is discovered before a total has been printed, it is often possible to correct it by using the deposit correction key, which subtracts in the withdrawal column, or the withdrawal correction key, which adds in the deposit column. If the error is not discovered until after the total has been printed, the usual procedure is to run the transaction through the second time. In either case, the teller must make a note on the reverse side of the "take-off sheet," including in the notation the number of the account in which the error occurred. These notations are checked with the tape and with the ledger cards by the chief teller to see that each correction is bona fide. The net total of all these errors must be added to or deducted from the totals of deposits or withdrawals or old balances when the totals are taken out of the machine at the end of the day.

If a customer comes in without a passbook and wishes to make a deposit, he is given a special form of duplicate deposit tag as a receipt. This tag is exactly the same size and shape as a passbook and takes the place of the passbook in the machine. The depositor thus gets a transcription of the entry and a statement of his balance in the same manner as though he had brought in the book. These duplicates are signed by the teller. The entry on the ledger is marked in ink N.P.B. meaning No Pass Book. When the customer brings in his duplicate deposit tag and desires that the entry be made in the book, the teller places the book in the machine, picks up the old balance in a special duplicate old balance key and enters the deposit using a special duplicate de-

posit key. This prints in the book in the same manner as a regular deposit but the fact that it was a duplicate entry is registered on the tape. The teller must retain the duplicate tag and turn it in at the end of the day with the "take-off sheet" to support the total shown thereon. If the customer comes in with his passbook but without his duplicate deposit tag, the teller makes out another tag and has the customer sign it as evidence of his having lost the first one. This signed tag is taken in place of the lost tag to support the entry on the machine.

INTERBRANCH DEPOSITS AND WITHDRAWALS

You may have been turning over in your mind the fact that ours is a branch bank and that we have interbranch deposits to handle. Thus far, seventeen of our largest branches are equipped with the machines. Whenever a customer from one of these seventeen branches presents his passbook at another branch so equipped, and wishes to make a deposit or withdrawal, the entry is made on the machine. The branch number prints immediately after the balance, so that entries may be traced. There are separate keys for interbranch deposits and interbranch withdrawals. Settlement is made between the branches through our branch clearings system. By running these items separately on the blotter, it is a simple matter to check the total as shown by the blotters against the total obtained on the "take-off sheet." If a depositor from a branch equipped with the machines wishes to make a deposit at a branch which does not have them, the teller may receive the deposit, transmit it to the depository branch in the usual

manner, but he must not make any entry in the machine passbook. If possible, the teller sends the passbook with the deposit to the depository branch of entry, with instructions to hold the book or to return it by mail to the customer, as the customer may direct. If the depositor does not care to release the book, the receiving teller will issue a duplicate deposit tag and instruct the depositor to present the tag and the book at the depository branch for machine entry. If the transaction is an interbranch withdrawal, we insist that the passbook be taken up, and forwarded with the withdrawal. The volume of interbranch transactions is comparatively small, however, and since the majority of those who travel will go to the main branch in a city, and since those are the branches which are equipped with the machines, we have little trouble.

SAVING IN LABOR

We feel that the installation of the machines was a practical and economical move from many standpoints. We were able to reduce the staff from twenty-four to eighteen, or by exactly the number of bookkeepers. The salary of these six bookkeepers alone paid for the machines in two years. In addition to the reduction in staff, we saved 162 square feet of valuable floor space and two windows. We secured a much neater passbook and ledger card. In fact a great many depositors went out of their way to remark about the improvement.

The passbooks are more nearly up to date. With the old system, the tellers did not always think to enter interest credit in passbooks when they

were posting deposits, and it was not uncommon to find passbooks which would show deposits and sometimes withdrawals entered over a period of several years, and then a number of interest credits all bunched together. This is confusing to the depositor, especially if you try to check up the balance in the ledger with the balances shown in the book during the intervening time. With the machines, the teller is forced to refer to the ledger card on every transaction, and since every line in the book must be accounted for, the teller must enter in the book any unposted interest credits before he can post a deposit or withdrawal. In this manner, the passbook is brought up to date every time it is brought to the bank.

IMPROVEMENT IN BALANCING THE LEDGERS

With the machines doing the posting and extending, the work of balancing the ledgers has been reduced to a minimum. The balances printed by the machine are much easier to read than the pen and ink postings of the average bank clerk, and this factor reduces the running time and the number of mistakes in running. We balance our savings ledgers once a month. When we posted with pen and ink, we would spend the spare time of ten days making the ledger runs, and the spare time and sometimes overtime during the remaining twenty days, checking out the differences. With the machines in use, we make all the runs and balance all the ledgers by the tenth of the month. A sight balance is now the rule, rather than the exception as it was formerly. When you see your tellers paying out money all day long, it gives you a

very comfortable feeling to know that your ledgers are in balance.

After the installation, we took out of the department all of the Navy accounts and used them as the nucleus of our new Harbor Branch, in a location more convenient to the Navy men. Then we took in an entire unit of savings accounts from another location. Rather than spread these accounts out over the four regular units, which we could have done very easily, we left them intact and they now constitute our fifth unit. The industrial and personal loan repayment accounts, about 3,000 in all, make up the sixth unit. The small number of accounts in this last unit is justified by the fact that they are exceedingly active, averaging almost one transaction per week per account. Excluding this unit, the other five are handling 40,000 accounts and will be able, we feel confident, to accommodate from 50,000 to 60,000 regular savings accounts, depending on activity, without any increase in staff, machines or floor space.

Discussion

THE CHAIRMAN: In handling customers, can you operate as rapidly with the machine as with the old pen and ink method, Mr. Smith?

MR. SMITH: When we first considered installing these machines we weighed what we thought were the possible improvements against the possible demerits, and we agreed among ourselves that it would probably be a little slower to work with the machine but that that difficulty would be more than overcome by the improved service, the accuracy, the protection, and so forth. So we settled back and expected it would take a

little longer to wait on the customers.

After our men became accustomed to where everything was, we timed them with a stop watch and we found they were handling transactions in thirty seconds, which includes locating the ledger card, setting up the old balance and the account number, placing it in the machine, counting the currency, and returning the pass book. I do not know what your time is in other banks, but that seems as fast as or faster than we were handling them before we had the machines.

JOSEPH C. BOGGIO (First & American National Bank, Duluth): May I ask how many tellers you have to each unit?

MR. SMITH: Two. They do the teller and the bookkeeper work.

V. J. GOODRIDGE (The Dollar Savings & Trust Company, Youngstown, Ohio): What is your experience as to the mechanical difficulties? Do the machines get out of order once in a while?

MR. SMITH: We have had very little difficulty with them. Of course, all machines get out of order once in a while. We have found these as mechanically perfect as any we have in the bank, and we have many machines.

MR. GOODRIDGE: It is the National Cash Register machine you are using?

MR. SMITH: Yes.

GEORGE W. WRIGHT (Bowery Savings Bank, New York): You keep a reserve machine, don't you?

MR. SMITH: We had a reserve machine for the first six months, but we had so little use for it that we no longer have it.

MR. WRIGHT: How many transactions per unit do you have per day?

MR. SMITH: I have brought some

figures along to show. Our average per employee in the department, which includes the chief teller, the department head, and every one else, is 1424 per month per man.

For purposes of comparison, I will mention this: There is an article by H. P. Strong, which appears in the Banker's Monthly of June, 1929, in which he reports a study he made of activity in savings banks; he found that the thirteen banks he studied were handling per employee per month anywhere from 644 items to 2127. If all these banks were of the same size, the average of the thirteen banks would be 1130 items. As I mentioned before, our average is 1424.

MR. WRIGHT: Previous to the machine installation, did you have the cards?

MR. SMITH: We had cards, yes.

MR. WRIGHT: You posted them in ink by hand?

MR. SMITH: We posted them with a regular commercial bookkeeping machine.

MR. WRIGHT: When you went to the National Cash Register machine, you did try posting the interest by machine?

MR. SMITH: That was posting interest to the ledger card.

MR. WRIGHT: Then you changed back to posting by pen and ink?

MR. SMITH: For that one transaction, we found it quicker to put twenty-five men on it than to have one man running it through the machine.

MR. WRIGHT: How long did you experiment on posting by machine?

MR. SMITH: Just the first period. We might find it just as quick now to adopt the orthodox method of posting with the machine.

MR. WRIGHT: When you posted by machine, did you post after the first of the month or before the first of the month?

MR. SMITH: Before the first of the month.

MR. WRIGHT: That is why you were slower. We did the same thing, and we not only found we got into a jam on errors, but we also found we had to make many corrections, whereas banks that have posted interest after the first of the month have been able to post by machine, and save time. I know one bank that we in the city consider very conservative, which went to the unit system and machines, and immediately went to posting by machine. They clean up in wonderful style. They do their interest and proofs and everything else inside of three weeks. They can do it in even less time, and they have over 90,000 accounts.

We tried posting by machine and did it before the first of the month, and went back to posting by hand. The chief clerk who was responsible for the recommendation for posting by machine was also responsible for going back to posting by hand; he is now advocating going back to the machine again, but posting after the first of the quarter.

MR. SMITH: That is very interesting. We also post our interest before the end of the interest period.

MR. WRIGHT: There are two things that come to my mind that might be interesting to you. We found that one of the things that caused us a great deal of trouble was the hand figures. We found we could read our machine figures very much better than we could read our hand figures. Otherwise, as you have said, you will find fewer errors in machine

balances than in pen and ink balances.

One bank in New York City, not far from the Bowery Savings Bank, was obliged to put in the machine because some of the depositors from our bank had deposits in that bank, and they went to them and said, "Why don't you use the machines? Look at what fine pass books the Bowery Savings Bank has. We can always read its balance."

MR. SMITH: We were not forced to it. We adopted it because we thought it would be safer, more economical, and better all around.

THE CHAIRMAN: Mr. Wright represents the Bowery Savings Bank, an institution that has more machine operated savings accounts than any other savings bank in the world, so that their experience in machine work is really the last word.

MRS. M. E. BONHAM (Security Savings Bank, Riverside, California): You may be interested in a little bank and what its experience has been with machines.

I have been very much interested in Mr. Smith's talk on the large bank. We have been using machines for two years now, and particularly at interest time I find that we get the customers out in much better shape than we did before, much faster. Of course, we post our interest in the machine. Just as soon as it is posted on the machine and as fast as the pass books come in, the interest is entered in the pass book, even if it is a little before interest time. That, of course, takes care of the really active accounts, people coming in regularly. That helps to cut down on the first of January and the first of July.

We had a happy thought in our bank that can be worked out. I think probably some of you at least

figure the interest as we do. The account must be in ninety days before an interest date to draw interest on that date. We have been talking with the machine people about getting four colors of ribbon. When we come back to the interest as on the first of October, the ribbon will be changed on our machine to a different color. In figuring the interest we would only go back to the different colored figure, and the first of January we would change it again. They are looking that up now to see if they can have the colors made.

WALTER T. JUDY (Kanawha Banking & Trust Company, Charleston, West Virginia): I should like to know what experience Mr. Smith has had with the little coin savings banks. If you use them, do you consider them worth while?

MR. SMITH: We do use them. At first we found that in many cases they were a nuisance; but we solved the difficulty, I think, by installing in our department a coin sorting accounting machine which we have placed in one of the units. If a customer comes into one of the other units with a bank, the teller will take it down there and dump it into the machine. When the total is secured that coin is turned over to the teller in whose unit the machine is located, and the originating teller receives an exchange for the coin so that he can use that against the deposit tag.

I might mention another thing that no one has asked yet, and I must confess I forgot to mention it: that is handling transactions which originate in other departments. We have an instalment collection department to which customers can bring instalment mortgages, for example. As payments become due they are made at

the bank instead of being made to the individual. The bank will then credit the account of the owner of the note.

Sometimes on the savings accounts, in order to get that through the machine into the record, we have found that the simplest way is to have the originating department issue a teller's exchange to offset its part of the transaction, and send the deposit tag and the debit half of the teller's exchange to the savings department where it is handled in the same manner as though the customer had come in with the money.

GEORGE H. WOODIN (Bowery Savings Bank, New York): Mr. Wright asked you about the average transaction the teller has, and as I understood you, you said 1400 a month, or an average of fifty a day or less.

MR. SMITH: That is right, per man, which includes the four batch

clerks, the department head and the chief teller.

MR. WOODIN: That would be 200 transactions within the unit. It might be interesting to you and the rest of the savings bank people to know that on Monday, which we consider our busiest day in New York—and we are open from nine until seven right through—our arrangement is a little different from yours and our tellers handle cash only; we have what we call a machine man to take care of the machine entries; our tellers average from 600 to 1100 transactions per Monday.

MR. SMITH: That is very interesting. I am sure that is an enviable record. As I mentioned, however, we really have more machines now than we need, but we have room for an expansion of perhaps anywhere from 40,000 to about 60,000 so that our record is not what you call a top-notch one.

Uniform Method of Figuring Interest

By WILLARD H. DRESSLER

CASHIER OF THE STOCK YARDS NATIONAL BANK OF SOUTH OMAHA,
OMAHA, NEBRASKA

Address before the Denver Departmental Conference

A 4% rate of interest in one bank is not necessarily the same as a 4% rate in another. The Committee on Bank Facilities and Service of the Savings Bank Division of the American Bankers Association, in its survey, conducted in 1928, discovered that fifty-two different methods of figuring interest were being used. In the four problems submitted with the questionnaire, the results obtained ranged from no interest up to \$126.85, all figured on the basis of 4%. The article explains in detail the reasons for this variance.

Mr. Dressler presents a sample problem which he solves by eight different methods, four of them the methods recommended by the Savings Bank Division of the American Bankers Association. The method which he considers most satisfactory is as follows:

"Interest is to be compounded and credited semi-annually and is to be paid from the first of each month on all sums remaining in the bank until the end of a semi-annual period, provided they have been on deposit for at least one calendar month preceding the semi-annual interest date. Deposits made after the first of each month will draw interest from the first of the following month. Withdrawals are to be deducted from the latest deposits. No interest will be allowed on withdrawals made during the six months' period."

THE depositor (and many times even the banker) thinks that 4% interest means 4%, no matter what method is used in figuring interest on his account.

If a customer goes into a grocery store and purchases a package of Smith's Soap Crystals for 25c, and a few days later goes into another grocery store across the street and purchases the same size package of Smith's Soap Crystals for 23c, he has a right to believe that he has received the same quantity of crystals in each case and thereby made a bargain in the second purchase. If, however, this same customer should ex-

amine the package and find that the first purchase contained a net weight of 26 ounces, and then examine the second package and discover the net weight of it to be 21 ounces, as shown by the markings on the outside of the carton, he certainly has good reason for losing confidence in one of these two merchants. While we have heard a great deal about evils of this sort, it does produce distrust in the minds of the people when such a discovery is made.

The depositor has the same right to expect that when he puts his savings in the bank which advertises interest at 4%, he will receive the same

return as if he had placed his account in the bank across the street advertising the same rate of interest. The fact is, he should, but research has proved that many methods are used in figuring interest on savings accounts, and that too often a 4% rate in one bank will produce a return very different from the return by the same rate, used in another bank. Undoubtedly, this is unfair to the customer and is poor advertising for the bank. These differences occur because bankers have found that in order to cut the cost of overhead expense, sometimes it is better to use one method of figuring interest than another. The depositor is certainly entitled to justice and an interest return that will measure up to the advertised rate. If there were but few deposits and no withdrawals, we would not need to discuss this subject. The activity of the account is what produces the possibility of variance in results obtained by using different methods of figuring interest.

In 1928, the Committee on Bank Facilities and Service of the Savings Bank Division of the American Bankers Association was charged with the responsibility of either finding a prevailing method, or devising a method or methods, which, regardless of the rate of interest, might be used by banks generally. This Committee made a survey of the United States and in October of the same year made its report to the Executive Committee. Out of 2,066 questionnaires sent out, 888 replies were received. It was found that 52 different methods of figuring interest were being used. In the four problems submitted with the questionnaire, the results obtained ranged from no interest up to \$126.85, all figured on the basis of 4%.

What are some of the reasons for

so wide a variance? For the purpose of encouraging deposits, many banks allow interest from the first of the month on deposits made during the first 3, 5, 7, 10 or 15 days of the month; some only on the first 10 or 15 days of the quarter or six month period. Suppose a bank allows interest from the first of the month on all deposits made on or before the tenth of the month: such a bank is actually giving away 108 days' interest during a single year. Is it not time that bankers should cease giving away gratuities in this form?

Some argue that many depositors are paid on the first of the month and do not find it convenient to go to the bank on the same day with their deposits. They claim these people should be accommodated by the allowance of one or more days' grace.

It must also be remembered that banks are restricted by law in the class of loans they can make on savings deposits; hence, they should have a reasonable time to invest these savings wisely.

DIFFERENT METHODS

In the foregoing survey it was discovered that there were banks that paid interest in both savings and commercial departments. In one of these banks, a certain customer had an account in each department. This customer allowed his deposit to remain on interest in the commercial department until the last day of grace, and then transferred his balance, or the major portion of it, from the commercial to the savings department, where he also received interest from the first of the month. It is unnecessary to record what should be done in a case of this kind.

About 75% of our banks compound interest semi-annually; most of the remainder figure interest quarterly. However, there are a very few that figure interest three times a year and a few annually. Most bankers agree that compounding interest for the shorter period encourages withdrawals. We all know that there are more withdrawals at periods when interest is paid or credited than at any other time. Moreover, it is also true that the bank which has the shorter period for the calculation of interest usually pays out more interest than that which compounds interest only semi-annually. This cost, plus the cost of additional work, brings to such a bank quite a handicap in its overhead when compared with the institution that uses the longer period. By adopting the semi-annual period as a basis for all banks, this disparity could be avoided.

Some banks deduct all withdrawals in the period from the original balance or the first deposits. Others figure interest on the minimum monthly or quarterly balance in the period. All of these practices render a wide variance in the interest paid to the depositor.

There seems to be considerable difference of opinion among bankers as to the date from which interest should be figured. Advertising interest from the date of deposit is unquestionably the best drawing card for encouraging the opening of new accounts, and perhaps of consistent and regular deposits. On the other hand, there are many who believe that interest should be figured from the first of the month on deposits made on or before a certain day in the month, and some would even restrict it to the first ten days of the quarter or semi-annual period.

It is my opinion that deposits made after the first day of the month should draw interest from the first of the following month. This plan seems fair to both the customer and the bank, when consideration is given to the fact that a bank must invest in certain securities as restricted by law. When days of grace are allowed, these depositors receive a return which their money does not earn and which must come from the earnings of other depositors whose funds are on deposit for the full interest period. Such a practice benefits one class of customers at the expense of the other. This hardly seems just.

It is a mighty fine thing to have the good will of your customers, but it is also difficult to tell just how far a bank should go in its liberality to depositors at a sacrifice of return to its stockholders. There is possibly a happy medium, and that, each bank must find out for itself. Much will depend on the character of the depositor and the environment in which he is situated.

At this time, there is no such thing as a uniform method of figuring interest on savings accounts, nor as long as bankers are allowed the privilege of exercising their own views on the subject, will we ever have such a method. Clearing house associations have not given much thought to the subject, or else have had but little success in setting up such a standard.

I believe that in the State of Kansas, the Superintendent of Banking has recently required banks to figure interest on a certain basis.

The only hope that I see for the adoption of a nationwide uniform plan is through the several state legislatures, with the American Bankers Association as sponsor. It will re-

quire the same constant effort, patience, and sacrifice that has produced other uniform laws affecting banking practices.

The survey heretofore referred to was one of the most monumental pieces of work ever undertaken by anyone dealing with this subject. In 1927 the writer made a similar survey, but addressed questionnaires to only about five hundred of our largest banks. In that survey there were only about a dozen different methods of figuring interest disclosed.

SURVEY OF THE SAVINGS BANK DIVISION OF THE A. B. A.

Because of its scope, I will refer almost altogether to the survey as made by the Savings Bank Division

Committee. The Committee's conclusions were reached after a thorough and exhaustive study of the subject. In the belief that it is the fairest to both the depositor and the bank, the easiest to understand, the most nearly just, and the most economical in its operation, the writer would select and recommend Method No. 1.

Since there are many things which are difficult to grasp from a word of mouth explanation, I have given a detailed analysis of the various methods named, in the hope that the reader will be able to grasp them easily.

For convenience, the following problem is used in all the methods demonstrated. Interest is figured at 4% per annum, thirty days to a month and 360 days to a year.

SAMPLE PROBLEM

DATE	WITHDRAWALS	DEPOSITS	BALANCE
January 1	\$.....	\$800.00	\$800.00
January 10 .....	.....	210.00	1010.00
January 28	100.00	.....	910.00
February 1 .....	.....	307.00	1217.00
February 15	400.00	.....	817.00
February 28 .....	.....	210.00	1027.00
March 4 .....	.....	100.00	1127.00
March 15 .....	.....	210.00	1337.00
March 24	325.00	.....	1012.00
April 6 .....	.....	450.00	1462.00
April 10 .....	.....	210.00	1672.00
May 4	700.00	.....	972.00
May 15	120.00	.....	852.00
May 28 .....	.....	300.00	1152.00
June 1 .....	.....	483.00	1635.00
June 10 .....	.....	300.00	1935.00
June 22	500.00	.....	1435.00

of the American Bankers Association.

The Executive Committee approved four methods which were developed from the fifty-two reported. In this paper we have used the principal methods in the survey as measured by the largest number of banks using them. We have also used the four methods recommended by the

METHOD NO. 1
(USED BY 144 BANKS)
(ALSO RECOMMENDED BY SAVINGS
BANK DIVISION, A. B. A.)

Interest is to be compounded and credited semi-annually and is to be paid from the first of each month on all sums remaining in the bank until the end of a semi-annual period, provided they have been on deposit for

at least one calendar month preceding the semi-annual interest date. Deposits made after the first of each month will draw interest from the first of the following month. Withdrawals are to for the full six months. We then follow down the balance column until we find the next lowest balance appearing in a later month. After calculating the difference between these

METHOD NO. 1

The smallest balance is found on January 1, \$800, which receives interest for six months.....	\$16.00
The next smallest balance is \$817, from which we should deduct the last used balance of \$800, leaving an increase of \$17. Since this increase comes from the deposit of January 10, of \$210, it will receive five months' interest .....	.28
The next smallest balance is \$852, from which we subtract \$817, leaving an increase of \$35, which is all that remains of the February 28 deposit of \$210. Hence \$35 will receive interest from March 1, or four months .....	.47
The next smallest balance in a succeeding month is \$1,435. By subtracting \$852 we have an increase of \$583, which draws interest for one month	1.94
Total interest.....	\$18.69

be deducted from the latest deposits. No interest will be allowed on withdrawals made during the six months. To begin actual calculations on the account, the first thing to do is to find the lowest balance in the period. That enables us, with many accounts, two amounts, we determine when the deposit was made that brought the increase, then allow interest on the increase for the rest of the period from the proper first of the month. This process is repeated until the last month of the period has been reached.

METHOD NO. 2

Under this method we first add all withdrawals in the interest period, which amount to \$2,145, and take the amount from the first deposits of the period. This cancels all deposits made up to April 6, except \$142 of the \$450 deposit on that date. By adding the \$142 to the April 10 deposit of \$210, we have \$352 that receives interest for two months	\$2.34
The May 28 deposit of \$300 and June 1 deposit of \$483 added together make a total of \$783, that receives interest for one month....	2.61
The \$300 deposit of June 10 is on deposit for less than a calendar month; hence it draws no interest.	
Total interest	\$4.95

to skip several months during which the balance has been decreasing, the deposits therefore not remaining until the end of the period. The lowest balance of course, is allowed interest

METHOD No. 2
(USED BY 139 BANKS)

Interest is to be compounded and credited semi-annually and is to be

paid from the first of each month on all sums remaining in the bank until the end of a semi-annual period, provided they have been on deposit for at least one calendar month preceding the semi-annual interest date. De-

The minimum balance in each of the six months follows:

METHOD NO. 4

(USED BY 75 BANKS)

Under this method interest is fig-

METHOD NO. 3

January	\$ 800.00
February	817.00
March	1012.00
April	1012.00
May	852.00
June	1435.00

$\$5,928.00 \div 3 = 6$ months' interest \$19.76

posits made after the first of each month will draw interest from the first of the following month. Withdrawals are to be deducted from first deposits. No interest will be allowed on withdrawals made during the six months' period.

ured on minimum balance for each quarter, but compounded quarterly.

METHOD NO. 5

(USED BY 62 BANKS)

Interest is to be compounded and credited semi-annually and is to be

METHOD NO. 4

In the first quarter the minimum balance is \$800, which receives interest for three months..... \$8.00

In the second quarter the minimum balance is \$852, which receives interest for three months..... 8.52

By compounding interest on \$8 earned in the first quarter, we have \$8 receiving interest for three months..... .08

Total interest \$16.60

METHOD NO. 3

(USED BY 129 BANKS)

This is known as the minimum monthly balance method, and interest is compounded semi-annually.

paid from the first of each month on all sums on deposit for six months; no interest on withdrawals. Withdrawals are to be deducted from the first deposits. If any interest is earned in the six months' period, it is payable

METHOD NO. 5

Since the withdrawals of \$2,145 exceed the deposit of January 1, there will be no interest on this account.

METHOD NO. 6

In looking for the smallest balance in the first quarter, we find on January 1, \$800, which earns interest for three months \$8.00

The next smallest balance in a later month of the quarter is \$817. Hence the difference of \$17 earns interest for two months, being all that remains from the deposit of \$210 made on January 1011

The next smallest balance in the quarter is \$1,012; hence the difference between this and the last preceding balance of \$817 is \$195, which earns interest for one month, being all that is left from the deposit made on February 28, of \$210.. .65

Interest for first quarter..... \$8.76

The smallest balance in the second quarter is \$852, which receives interest for three months..... \$8.52

The next smallest balance in a succeeding month is \$1,435. The difference between \$1,435 and \$852 is \$583, which earns interest for one month. (The whole of the deposit made on May 10 and \$283 of the deposit made on June 1, are included in the \$583.)..... 1.94

Interest for second quarter..... \$10.46

Interest for six-month period..... \$19.22

METHOD NO. 7

Starting with the smallest balance in the quarter, we have \$800, which earns interest for three full months..... \$8.00

The next smallest balance in a succeeding month is \$817. The difference between \$817 and \$800 (preceding balance), is \$17, which is all that remains of the \$210 deposit made on January 10. This \$17 earns interest for two months and twenty-one days15

The next smallest balance in the first quarter is \$1,012. The difference between \$1,012 and \$817 is \$195, which is all that remains of the February 28 deposit of \$210, and bears interest for one month and three days..... .71

Interest for first quarter..... \$8.86

The smallest balance in the second quarter is \$852 on May 15, and receives interest for three months..... 8.52

The next smallest balance is \$1,152 on May 28. Hence \$300, the difference between \$1,152 and \$852, earns interest for one month and three days..... 1.10

The next smallest balance is \$1,435 on June 22. The difference between \$1,435 and \$1,152 is \$283, which is all that remains of the deposit of \$483 made on June 1; hence it earns interest for one month..... .94

Interest for second quarter..... \$10.56

Interest for six-month period..... \$19.42

at the end of the next six months' period, if account has not been withdrawn.

METHOD NO. 6

(USED BY 26 BANKS)

(ALSO RECOMMENDED BY SAVINGS BANK DIVISION, A. B. A.)

Under this method, interest is to be compounded and credited semi-annually, and is to be paid from the first of each month on all sums remaining in the bank until the end of a quarterly period, provided they have been on deposit for at least one calendar month preceding the semi-annual

remaining in the bank until the end of the quarterly period, provided they have been on deposit for at least one calendar month preceding the semi-annual interest date. Withdrawals are to be deducted from the latest deposits, if any; otherwise from the balance at the beginning of the quarterly period.

METHOD NO. 8

(RECOMMENDED BY SAVINGS BANK DIVISION, A. B. A.)

Interest is to be compounded and credited semi-annually and is to be paid from date of deposit on all sums

METHOD NO. 8

The smallest balance in the period is \$800 on January 1, and receives interest for six months. \$16.00

The next smallest balance for the whole period is \$817. Subtract \$800 from \$817 and we have \$17 increase, which is all that is left of the deposit of \$210 on January 10, that remains on deposit throughout the period. The \$17 draws interest for five months and 21 days. 32

The next smallest balance is \$852. Subtract \$817 from \$852 and we have \$35, which receives interest to the end of the semi-annual period, and is all that is left of the deposit of \$210 made on February 28; hence, it earns interest for four months and three days. 48

The next smallest balance is \$1,152, from which should be taken \$852, leaving \$300 that earns interest for one month and three days. . . 1.10

On June 22, we find the next smallest balance, which is \$1,435. By subtracting \$1,152 we have left \$283, which receives interest from the day of its deposit, June 1, for one month. 94

Total interest for the period. \$18.84

interest date. Deposits made after the first of the month will draw interest from the first of the following month. Withdrawals are to be deducted from the latest deposits, if any; otherwise from the balance at the beginning of the quarter.

METHOD NO. 7

(RECOMMENDED BY SAVINGS BANK DIVISION, A. B. A.)

Interest is to be compounded and credited semi-annually and is to be paid from date of deposit on all sums

remaining in the bank until the end of the semi-annual period, provided they have been on deposit for at least one calendar month preceding the semi-annual interest date. Withdrawals are to be deducted from the latest deposits, if any; otherwise from the balance at the beginning of the period.

In conclusion may I say what a wonderful thing it would be if a just, sound, economical, and uniform method of figuring interest on savings accounts could be established and enforced for all banks. It would bring

the figuring of interest down to an almost exact science instead of the many sided, haphazard schemes in vogue today.

For material used in this paper, the writer is deeply indebted to the Savings Bank Division of the American Bankers Association, and to J. V. Holdam, assistant vice president of the Chattanooga Savings Bank and Trust Company.

Discussion

JOSEPH C. BOGGIO (First & American National Bank, Duluth): Mr. Dressler, I had the opportunity some time ago of reading the report suggested by the A.B.A. and I attempted to come to some personal conclusion concerning the methods recommended.

It is my conception that the A.B.A. committee failed to consider the activity cost of some of the accounts. Taking the account as entered there, one factor enters in, the cost of operation. I have had the opportunity of questioning bankers throughout the country at different times, calling on them and checking on the cost of operation, and for every entry, costs have varied from approximately eighteen cents to close to thirty-five cents per entry in the large Chicago banks. If those figures are not right, don't blame me for them; they were given to me. If they are figuring on the basis of 4%, and the cost of operation is figured as method No. 1 suggests, then the cost of operating that account plus the interest paid would practically come up to 5%.

Must we not consider in our discussion the activity of an account before basing just what might be determined the exact cost of operation and

the exact amount of interest? We rather believe we should consider the interest of the stockholder of the bank and the interest of the customer besides, bringing the two as close together as possible, and then consider the cost and the amount of interest to pay. Do I make my point clear?

MR. DRESSLER: Yes, I think I understand your question.

There is no question in my mind but that banks that have both commercial and savings departments can easily take care of that matter by requiring savings account customers, that is, savings accounts so active as to render them really non-savings accounts, to place their accounts in the commercial department, provided, of course, that they have enough money to pay their way.

In a strictly savings bank, the only way I see would be for you to educate your customer to what the idea of savings is and teach him not to make a commercial account out of his so-called savings account.

In 1927 I made a survey of the same subject, covering the large banks of the United States, and I found that the differential between the advertised rate and the rate actually paid varied from a small fraction to one-half of one per cent. In other words, if a bank advertised 4%, it probably actually paid $3\frac{1}{2}\%$. That is the point you are raising, the activity of the account.

The only answer I can give is the one I just repeated a moment ago. If it is too active put it in your commercial department or educate your customer to what a savings account really means.

MR. BOGGIO: What would you consider the example given, from the viewpoint of a savings account?

MR. DRESSLER: The example on the board would not be too active, in my judgment, to be classed as a savings account. There are only six withdrawals in six months. I do not think that is a very bad record. While it is active, it is not bad, and I should not consider it a nuisance. It is offset by an increased balance as it goes through the period. That is worth while, also. That is a thing that each bank, I presume, will have to determine for itself—whether the account is being operated or carried at a loss. The moment it becomes a loss, it should either be eliminated or else put on a profitable basis.

WILLIAM H. SIMMONS (First City Trust & Savings Bank, Akron, Ohio): I wonder if you would be interested in knowing the method we use. If so, I will be glad to put it on the board. It compares favorably with No. 7. Have I your permission to put it on?

THE CHAIRMAN: Yes, surely.

MR. SIMMONS: We pay interest from date of deposit if left ninety days. In the first place, we have \$800 for the month of January. The withdrawals within that ninety-day period left \$17 increase, and the \$17 was in there for two-thirds of a month, which is \$11 added as plus for the month of January.

February had \$817, and March had \$852, which is an increase between the \$817 and the \$852 of \$35. But as the increase of \$35 took

place on the last day of the second month, it is considered as interest on the first of March.

Then for the last period we would draw a line right here, what we call a hook, in red pencil or red ink. No deposits made after the first three business days of the second quarter would bear interest in that period. The interest for the last quarter is \$8.52.

That is, using the method of interest at the rate of 4%, if deposits are made within the first three business days of the month, they will bear interest as of the first of the month. I might say that the cost of our interest for one period will be around 1.94%, the next about 1.93%, and the last about 3.87% at the rate of 4%. This is in a bank of \$50,000,000 resources having \$25,000,000 in savings accounts.

THE CHAIRMAN: Thank you.

MR. DRESSLER: I might say that I did not attempt, of course, to give all the different methods that are used.

I have reduced this to printed form for your use if you care for it. I have a great many copies at home, and some extras here. If anybody wants them, you are welcome to take them.

I found in my work in preparing this paper that the only way I could grasp it easily was to take a detailed analysis of an actual problem and follow it through; that is why I have gone into the detail I have.

Insured Savings

By FORMER JUSTICE EDWARD A. RICHARDS

PRESIDENT OF THE EAST NEW YORK SAVINGS BANK, BROOKLYN, NEW YORK
Address before the Denver Departmental Conference

Former Justice Richards presents in detail the plan of The East New York Savings Bank of Brooklyn, New York, to combine life insurance with systematic saving. He proposes to help those who earn and save first, and then spend; to give incentive, encouragement, and protection to the frugal, thrifty man who seeks to build financial independence, instead of protection to a creditor against a spendthrift debtor who has anticipated and spent his future earnings.

The bank seeks and receives no profit on the insurance. Since group insurance is term insurance, there is no surrender or paid-up value at the end of the plan or upon cancelation.

It is the belief of Former Justice Richards that "this plan should be presented by banks directly to depositors without any intermediary agency which seeks a commission or makes a charge for procuring accounts. The minute such an agency intervenes between the bank and the depositor, you are very apt to have a selfish interest working against both, and misrepresentations made to induce sales."

FOR many years bankers, interested in savings and thrift accounts, have sought a competent and legal means to combine life insurance with systematic saving. All of us recognize the economic value of both. Many plans have been suggested and many tried and discarded. We, of The East New York Savings Bank of Brooklyn, New York, believe that we have a plan which is meritorious and advantageous both to the depositor and to the bank.

THE NEW YORK STATE GROUP INSURANCE LAW

Our plan is operated under the provisions of the New York State Group Insurance Law, which law is also in force in many other states.

This law permits to be insured as a group "those persons who become borrowers from one financial institution,

. . . . or those who become purchasers of securities, merchandise, or other property from one vendor, under an agreement to pay sum borrowed or to pay the balance of the price of the securities in instalments over a period of not more than ten years, to the extent of their indebtedness to said financial institution or vendor. . . ."

This law, as you notice, is designed primarily to protect creditors against the death of debtors, but by so doing it also protects the debtor's estate. If the debtor lives, he will very likely pay his instalments in full unless he is incapacitated by sickness or accident. If he dies, the insurance company pays the balance of the bill. Insurance against sickness and accident may also be included in the plan, but this we have not done.

Commercial banks making small personal loans, sometimes called in-

dustrial loans, use this form of group life insurance for their protection, as do also stock and bond houses that cater to the man of small financial means, and automobile and radio dealers and others who sell on the instalment plan.

As has been said, when the creditor is protected by life insurance taken out for his benefit on the life of the debtor, the estate of the debtor is also protected because the proceeds of the life insurance relieve the debtor's estate from the payment of the balance of the bill.

Those who so operate under this law help only people who spend before they earn. Their plan is an incentive and inducement to the man who is willing to live beyond his means and pay for present luxuries out of future income.

What I propose to you is that we help some of the old fashioned folks who still believe that it is better to earn and save first, and then spend. Why not use this same principle of group life insurance protection to encourage men and women to build a competency, to gather together a modest fortune and thereby insure financial independence, happiness, prosperity, and contentment in future years?

What can be more worth while than to help frugal men and women purchase on the instalment plan and protect by insurance an interest bearing bank account? Certainly, it is far better to encourage the purchase of such a security on the instalment plan than to promote the purchase of speculative stocks or expensive luxuries often well nigh worthless before the balance of the purchase price is paid.

We, of The East New York Savings Bank, have a plan by which

we seek to do that very thing. We know that our plan is workable, meritorious, and beneficial, both to the bank and to the depositor.

Our plan would be much more simple and easier to explain if the law permitted to be insured as a group all persons who undertake under a savings plan to accumulate with a savings bank a specified sum of money over a period of months or years by making stated deposits with such bank at regular intervals, such insurance to be to the extent of the balance unpaid on such savings plan.

ADJUSTMENT OF THIS PLAN UNDER THE LAW

We have, however, worked out a plan which we are sure may be legally operated under that portion of the group insurance law which permits to be insured as a group persons who become borrowers from one financial institution, or those who become purchasers of securities under an agreement to pay the sum borrowed or the balance of the price in instalments over a period of years.

There is no doubt but that a savings deposit at interest, or entitled to interest dividends, is a "security" and an "investment" under the law.

When I give to a depositor a savings bank pass book with \$1,000 credit entered therein, I am putting into the hands of that depositor a security just as good as and probably better than a railroad bond, the principal of which is payable at a definite time with interest semi-annually.

PASS BOOK SECURITY FOR THE LOAN

Under our plan we practically sell

to our depositor a pass book with a definite credit entered therein and let him pay for it on the instalment plan. If he wants \$1,000 "insured saver's account" we give him a pass book with \$1,000 credit, and take his note for the amount of the credit and his promise to pay that note in monthly instalments of \$20. Under the New York law, savings banks may not loan unsecured. We may loan on the security of our pass books. We therefore take an assignment and pledge of the pass book as security for the payment of the note and the instalments. Our depositor has therefore become a borrower from our institution, and as such may be insured under the group insurance law for the difference between the amount of the borrowing and the amount from time to time paid on account thereof.

We can also operate our plan under that part of the Insurance Law which permits to be insured those "who become purchasers of securities from one vendor" under an agreement to pay the balance of the price of the securities in instalments over a period of years. Fortunately, our savings bank law permits our banks to contract with depositors to repay deposits when, together with dividends credited thereon, they shall equal a specific sum, and may issue as evidence of such contract a "certificate" setting forth the given sum to which such deposits shall accumulate. Such a contract and certificate is under the law a security. "Securities" are defined as "written promises or assurances for the payment of money as stocks and bonds, and so forth," or "written assurances for the return or payment of money as evidences of indebtedness."

We may issue to a depositor a cer-

tificate for \$1,000 and agree to pay him \$1,000 when instalment deposits made on account thereof plus accumulated dividends equal amount of the certificate. We take from the depositor a contract to make deposit payments at the rate of \$20 per month per \$1,000 certificate. The depositor has thereby become a purchaser of a security from us and under the group insurance law we may insure his life for the difference between the amount of the certificate and the amount he has paid on account thereof plus accumulated dividends.

The insurance in each case is written for the benefit of the bank but, of course, immediately enures to the benefit of the depositor's estate or beneficiary if one be named, because the minute the bank receives the proceeds of the insurance, the depositor's obligation is paid in full and the bank account and certificate, free and clear of any obligation, become the property of the deceased depositor's beneficiary or estate.

Our plan gives incentive, encouragement, and protection to the frugal, thrifty man, who seeks to build financial independence, instead of protection to a creditor against a spendthrift debtor who has anticipated and spent his future earnings.

A \$1,000 Insured Saver's Certificate pays in full (with accumulated dividends at $4\frac{1}{2}\%$ per annum) by the deposit of \$20 a month for forty-seven months. Since the first deposit is made in advance, the plan matures in forty-six months. During that time the account earns about \$85 interest. The plan costs the depositor a total of \$24.

We take from our depositor (whom we call an "insured saver")

an application which requests our bank to open an account in his name in trust for a stated beneficiary and asks us to enter an "insured deposit" of from \$500 to \$5,000 under our "Insured Saver's Plan." One clause in our application is a demand note for the amount of the insured deposit. As collateral security, the depositor assigns the pass book to be issued.

The insured saver agrees to pay and deposit monthly a sum equal to \$10 for every \$500 of insured deposit until the amount credited in the account equals the amount of the insured deposit.

The applicant asks the bank to secure and pay for group life insurance to cover the balance from time to time due on his obligation, and agrees to pay the cost of the plan which over the whole period is \$24 per \$1,000 account, but is payable \$10 a year the first year; \$8 the second; \$4 the third and \$2 the fourth, in semi-annual instalments in advance, which amounts he authorizes the bank to deduct from his account. The applicant also gives certain information required by the insurance company.

The bank submits this application to the insurance carrier and receives an acceptance or rejection within a few days. If and when the risk is accepted, the bank issues to the depositor a duplicate pass book with the amount of the insured deposit and the first instalment entered therein, holding the original pass book under the assignment and pledge. The bank also issues an "Insured Saver's Protective Certificate" setting forth the terms of the arrangement and certifying that group life insurance has been secured and is carried with the bank.

NO FORFEITURE FOR PAYMENTS IN ARREARS

Under a group policy issued by the Brooklyn National Life Insurance Company, the insurance is carried through the terms of the contract, or until the depositor becomes three months in arrears, in which event the insurance is canceled without notice. The cancellation of the insurance means no forfeiture to the depositor. He loses only the semi-annual amounts which he has paid toward the cost of the plan, and for that he has had full value in insurance. He still has his monthly deposits and all interest dividends that have been credited.

BANK NOT SEEKING PROFIT

The bank seeks and receives no profit on the insurance. Since group insurance is term insurance, there is no surrender or paid-up value at the end of the plan or upon cancellation.

Depositors may be accepted in this plan without physical examination if between the ages of sixteen and fifty-five years, in apparent good health, and regularly employed. We, however, limit our plan to the ages between twenty-one and fifty years. Housewives engaged in home duties alone are acceptable for a limited amount.

In four months this bank, which has assets of about \$45,000,000 and about 90,000 depositors, has opened a trifle more than 1,000 insured savers' accounts in which the depositors have undertaken to deposit an average of about \$1,200. Our experience already indicates that the plan induces regularity of deposits and decreases mortality in accounts.

The plan is so unique and unusual that some difficulty has been experienced in selling it.

The fact is that there are a multitude of thrift plans with insurance features being offered. Practically all involve a substantial service charge or forfeiture of principal in case of failure to complete the contract. It is our thought that this plan should be presented by banks directly to depositors without any intermediary agency which seeks a commission or makes a charge for procuring accounts. The minute such an agency intervenes between the bank and the depositor, you are very apt to have a selfish interest working against both, and misrepresentations made to induce sales.

Sales resistance with us is daily diminishing. It is becoming easier each day to open such accounts. We believe that if insured savers' accounts were generally known and understood and available directly through many banking institutions, they would become very popular and a great inducement to systematic saving.

Discussion

THOMAS H. O'NEILL (Bowery Savings Bank, New York): I want to tell Judge Richards that I am down on the Bowery where I meet a good many of the garment workers, the needle trade, and so forth, and how much interested they are in the insurance plan that the banks are getting out. I suppose I have five or six inquiries of different dates on this insurance plan. They are very much interested in it. It is just beginning to take hold, and I think it will be a great success.

JUDGE RICHARDS: May I say a word about that?

Already there has been organized at least one agency that is selling as its own this plan which we have devised. They are commercializing it, and they are adding to the cost a sufficient charge to make it pay them. They are asking banks to agree to give them a certain percentage of the balance in that account at the end of various periods.

Personally, I think it is wholly unfair for a commercial agency at this stage to come in and try to sell our plan—for it really is our plan—as their plan throughout the state of New York and throughout the nation. One reason I am opposed to it is that they are going to ruin it before it gets started. Already the Commissioner of Banks in Pennsylvania has written me about it. He is opposed, as I am opposed, to interposing between our banks and our depositors a commercial agency that is going to see how much they can get out of it for themselves.

This thing ought to be and can be sold directly by the banks to the depositor, and if we folks in the banking fraternity will get together and all of us advertise this thing, you will have people coming into your bank saying, "I want to open an account but I want my account insured," rather than, "I want to open an account." It will be a question of whether they will take it with or without the insurance feature.

So I am asking you, when this thing is presented to you by a commercial agency, to wait until some of us can try it out; then let's try to get together and formulate a uniform plan, if that can be done, and do it for the benefit of banking interests rather than for the benefit of some commercial agency.

DON D. LOVELACE (Harris Trust & Savings Bank, Chicago): As most of you people know, as Judge Richards knows of course, the idea of the savings insurance plan has been in effect for a number of years. I do not know of any plan for obtaining new business for savings departments and savings banks, however, that has been more abused than the combination of savings and life insurance. The reason it has been abused is just the reason Judge Richards mentioned a moment ago. I think his warning is entirely opportune and should be heeded.

We have had a savings and insurance plan in the bank for about nine years, and during that time we have had about 30,000 people apply for the account. At the present time we have about 9,000 of the accounts on the books with a total objective of about \$11,000,000.

As Judge Richards has said, we find that this plan does help to stabilize the depositor and the deposit, but the thing that I want to emphasize is the warning that Judge Richards issued, because there have been a number of organizations over the entire country that have been calling on banks attempting to capitalize on something that banks themselves started, and that only banks are qualified to carry through.

I have heard some very unusual things about this, I might say almost unbelievable things. I recall that the vice president of one of the Detroit banks was at my desk and said that they had started the plan with one of their local insurance men with an outside sales organization, and during the first month they received several hundred accounts. They thought that at last they had found the one thing

they had been seeking for years, something that would quickly increase their savings deposits. When the second month came around they noticed that not very many deposits came in. They began to get in touch with the people to see what the trouble was, and they found that these agents of the outside organization who had been employed to obtain the accounts on a commission basis had gone to the people and told them that all they had to do was make one deposit of \$10; that as soon as that deposit was recorded in the bank, the bank would make application for \$1,000, a ten-payment life insurance policy on their lives, and that the income from that \$10 deposit would be sufficient (1) to pay them the regular rate of interest on their \$10; (2) to pay the cost of the ten-payment life insurance policy premiums; and (3) to give the bank a sufficient return to make it interesting to the bank.

Since the story came from a banker, I could not doubt that at all, but I thought there must be something a little unusual that he wasn't familiar with. However, I have heard that same story from two other people since, one a man who was in charge of that sales organization, who came to our place trying to get a position as sales manager. When I pinned him down to it, he admitted that that was true. The other was from a member of his organization out selling it.

That is extreme, but I have had dozens of incidents that were almost as bad as that reported to me by letter or in person from banks all over the country.

As Judge Richards has said, it is our impression in Chicago that the savings and life insurance plan does

hold possibilities. We have had our plan in effect for nine years, but there are still a good many things to be ironed out and possibly unified by the various banks (I understand there are about 200 banks operating this plan over the United States) before it can be made entirely fool proof and entirely satisfactory to all concerned. That one thought of watching out for these people who are trying to capitalize on the name and the good will of the banks is something that every one should keep in mind.

WILLARD H. DRESSLER (Stock Yards National Bank, Omaha): I am not sure that I caught the proposition as you covered it, but suppose I take out an account of \$1,000 today: I give a note for \$1,000 and I get a specialty deposit; then on September first I pass out after having paid in \$60 on the note. What I did not quite gather is how you are protected, because you are going to pay up the note and pay my estate \$1,000. You probably covered it, but I didn't catch it.

JUDGE RICHARDS: When you come in and borrow \$1,000, we credit your account with \$1,000. You owe us \$1,000. We so arrange it that we charge you no more interest on your note than we credit you on your account, so one offsets the other. You lose nothing by that. We have a blanket policy insuring the bank for the difference between the amount of the instalment deposit and the \$1,000, should a person die. If the person should die after he has deposited \$60, as you suggest, the insurance company pays us \$940. Now what have we? We have \$1,000 credits; \$60 credit and \$940 credit, or a total of \$2,000. The depositor owed us \$1,000, on his note which

we hold. We charge his note to the account; the balance of \$1,000 due on that account, absolutely free of debt, the beneficiary named in the account may have on demand.

MR. DRESSLER: What company furnishes that insurance?

JUDGE RICHARDS: Brooklyn National Life Insurance Company, 26 Court Street, Brooklyn, through a man named Edmund Ely.

JOSEPH C. BOGGIO (First & American National Bank, Duluth): I might give you some experience that we had with the savings life insurance policy. Several years ago one of the life insurance companies in the state of Minnesota came into our city and approached one bank on the insurance savings plan; one bank refused unless the other came in. It was a new experiment and consequently it was probably felt that one bank would be overstepping the other; as a matter of courtesy all the banks joined in. That was probably the bad feature of it.

The policy was along this line. Let's say that an individual took the \$1,000 policy. That individual would deposit an average between \$8 and \$10 a month. At the end of each period, such as the first year—the period for payment of the premium was semi-annual, and after that annual—the premium cost about \$20, probably a little bit more than that. Presuming it was a ten-year payment and that the individual might have died some time between the first and the tenth year, the policy stipulation was that the insurance company would have paid the full \$1,000 to the beneficiary and then of course there was left in the bank whatever amount the depositor had deposited in trust for the beneficiary. If the individual

died at the end of the ninth year and had a \$1,000 account, during that period he would probably have deposited, less the premiums, less the interest on the savings account and plus the dividends from the insurance company, between \$700 and \$750, and would have received on top of that the \$1,000 from the insurance company. So if the individual died in the ninth year, instead of \$1,000 the beneficiary would have received close to \$1,700 or \$1,800.

If the individual was living at the end of the tenth year he would have had on deposit at the bank approximately \$850 or \$900 or \$950, according to the amount paid in, and according to his age, of course. Then he would have had the cash value of the policy, which would have been anything from \$150 to \$250, so that at the end of the tenth year he would have received \$1,000 or better.

JUDGE RICHARDS: May I suggest that really all he did there was to open an account in your bank, accumulate money, pay his life insurance premium; if he died he had the account and the insurance. That is no insurance plan at all. That is simply giving a life insurance com-

pany an opportunity to use your bank to help its business.

This plan that I outline is a real insured savings plan because you start with a savings account, and you carry the savings account through and try to reach your objective. If you live, you reach it; if you die, it is reached through insurance.

The insurance in your case was written for the benefit of the depositor; in our case it is written for the benefit of the bank, the creditor, but in yours for the benefit of the debtor or the depositor.

I think, therefore, that the plan I outlined is going to keep away from us this commercial agency that may intervene and put us in a position where we can give the benefit of insurance without selling insurance. My bank is not an insurance agency. It need not be an insurance agency because we hire insurance; we don't sell it. We go out and buy it. We go to an agent for the Brooklyn National Life Insurance Company and he insures the bank so that if that depositor dies the balance of that note will be paid; of course, since the note has been paid, the account is free of the debt.

Those Unprofitable Services

By R. E. CHAMBERS

VICE PRESIDENT OF THE NATIONAL SHAWMUT BANK OF BOSTON,
BOSTON, MASSACHUSETTS

Address before the Denver Departmental Conference

That "the laborer is worthy of his hire" is just as true when applied to a corporation as to an individual. There are certain services to which the customer is entitled, and which he has, in a sense, paid for, when leaving his account with the bank. But at present we find banks all over the country rendering a vast number of services, many of which are not only unprofitable, but some of which even seem unrelated to banking. Many of these services are, of course, valuable in the creation of good will or as advertising, but there are a great many such services which cost very much more than their possible returns.

Banks that carry checking accounts make a service charge for small accounts. Yet how many are allowing savings customers to make deposits creating balances that are never very high, and yet allowing them cashier's checks in payment of bills, almost without limit? Or consider the custom, not encouraged but allowed, where a depositor establishes a small savings balance, apparently for the sole purpose of avoiding collection charges on checks; or the practice of offering to receive from their savings depositors, securities and other valuables, for safekeeping without charge. Mr. Chambers goes on to enumerate many other services whose value to the bank he questions most seriously.

WITHOUT service, in its broadest and best meaning, both individual and business life would be an uninteresting and rather drab affair. On this any thoughtful group of people will be found in almost complete agreement. Service is expected from others and it follows that every business should in return do its full share. In a like manner, the individual renders a definite service to all others forming a part of our complex and closely interrelated social order. In both cases we find an almost immeasurable expenditure of time and money. With the services so rendered there comes a certain satisfaction gained in no other way. On the other hand, however, both are subject to abuses much alike in nature, that is, calls for services

to be rendered without remuneration, often coming from parties who have no reasonable ground for making such requests.

The purpose of the consideration of this very real problem, particularly as it has to do with banks, is to see if we can arrive at a common understanding and solution of the whole proposition.

Let us start with the frank statement that in order to be successful, any business, particularly a bank, must have as one of its fundamental principles and chief guiding motives, service. But having gone this far, we should add, within certain limitations which are just and equitable. This really means that extra outside or unreasonable service, without any direct or indirect return to the bank, should

not be offered or even considered. There are certain services to which the customer is entitled, and which he has, in a sense, paid for when leaving his account with the bank—clean attractive quarters, intelligent handling of his business, courteous treatment, and so forth. But most banks go far beyond this. The present condition which finds banks all over the country rendering a vast number of services, many of which seem unrelated to banking, is but the natural outcome of our, shall we say, over-enthusiasm of a few years ago.

The choice of the subject is in a way unfortunate in that technically it bars the consideration of any services other than those known to be losing ones. To discuss the question fairly, we should put the word unprofitable in quotation marks and then determine if the term is well applied. It is the so-called unprofitable services which we want to consider. Many times we so classify parts of our work, with little or no investigation simply because they are bothersome at a given point in the machinery. To draw the line clearly between profitable and unprofitable services is admittedly difficult. It is not fair automatically to brand any service as being either with or without adequate return. The proper answer will depend largely on just what is used as a measure of profit or loss. If we use money, we immediately bring ourselves face to face with the question as to whether we mean direct profits in tangible form, or the indirect ones not so easily traced. Should good will be considered a profit? Advertising? Then, too, there will be a difference of opinion depending on whether the question is discussed from the angle of mutual savings banks,

stock savings banks, or the savings department of a commercial bank.

You see, it presents a wide field and a variety of opinion. This subject is being presented today as one on which we have come together to confer, rather than a complete coverage of the whole matter. It might be well to run over a few of the facts bearing on the subject and then leave the matter for discussion afterward.

Let us look at some of the services granted by banks in various parts of the country either in connection with or in addition to their regular business, but not strictly related to the deposit, safekeeping or paying of funds, which are the usual recognized functions of a bank.

REPORT OF CURRENT BANKING SERVICES

Recently a committee of bankers appointed by the Stockholders' Committee of the Federal Reserve Bank of Boston made a report of a study of current banking services. It appeared in a printed booklet of some thirty-four pages, and makes an exceedingly interesting document. Most of the services noted are highly commendable. At one point there is presented a list that is referred to as convenience services. I presume the list did not contain all of these convenience services, but there were enough to show the great diversity. I counted 105 different services in that list. Among them were only three or four which I would consider even debatable as to whether or not the banks giving such services ever receive any money returns. Other similar reports are just as enlightening. We find listed things ranging from helping the store owner keep his windows clean

to the free use of the bank's airplane, and from employing a veterinarian to presenting university scholarships for essays on economic and financial subjects. Food for thought, isn't it?

Most of the services referred to in such lists will fall into one of several classes: the honest but sometimes unreasonable belief on the part of the depositor as to what the bank should do for him; general abuses; creation of good will; general advertising; and efforts on the part of some banks to "keep up with the Joneses," business-wise speaking. I will not attempt to allocate them but allow you to.

As this particular program is part of the Savings Departmental Conference, we will keep largely to the savings aspects of the question. It will not only be difficult, but will have a tendency to divide the interest, should we attempt to consider all questions which arise from both the angle of the mutual savings bank and that of the savings department. After all our object is to get a clear understanding of the problem as a whole and probably enough will be developed to be helpful to both classes. I presume the chief distinction between the two will be that in the mutual savings bank all profits accrue to the benefit of the depositor as distinct from the stockholder, and therefore something in the way of free or unprofitable service might be justified for the one whereas it could not be for the other. This can properly be dismissed, I think, after you have answered to your own satisfaction the argument that any expense charged to the profit and loss of a mutual savings bank is shared by all, infinitesimal though this share may be, but the benefit is derived only by those who, comparatively few in number, use the free services.

CASHIERS' CHECKS

Banks that carry checking accounts make a service charge for small accounts. Where there is special activity, oftentimes an extra charge is made. Yet how many are allowing savings customers to make deposits creating balances that are never very high and yet allowing them cashiers' checks in payment of bills, almost without limit? Because it is a savings depositor, no charge is made. Yet the service rendered is much more expensive both in time and money than if the transaction were put through a checking account. This is in addition to the high rates of interest paid on the savings balance, ranging up to $5\frac{1}{2}\%$ in some banks. Unprofitable in the extreme, no matter how you look at it!

Take another similar service, or I presume it should be more properly called an abuse. I refer to a custom, not encouraged but allowed, whereby a depositor establishes a small savings balance apparently for the sole purpose of avoiding collection charges on checks which he receives from time to time. Most of the cases of this kind involve quite a number of transactions. But does it build up a balance? No, because after two or three days, when the customer assumes that sufficient time has been allowed, he comes in and draws the entire amount, leaving his small balance just where it was. Certainly this can be classed as an unprofitable service, which is getting to be more and more of a problem in certain banks.

FREE SAFE DEPOSIT BOXES

And again, what justifies the practice in some banks (particularly

those which have safe deposit boxes to rent and a trust department) of offering to receive from their savings depositors securities or other valuables, for safekeeping without charge? Some even go so far as to allow the individual use of a safe deposit box. Vaults and safes cost money. Things what are worth keeping are worth paying to safeguard. Most people who are reasonable see it in this light. Yet we continue to render this service which is not only unprofitable but is actually putting us in a position of losing the income to which we are justly entitled.

KEEPING OPEN ON SATURDAY AFTERNOON

If we could free our minds entirely from the feeling that it is a thing we must do, I wonder just what sane reason would dictate as the answer to the proposal, adopted by so many banks, of keeping open Saturday afternoon or evening or both. Industrial business finds itself pretty well established on the basis of a five and one half day week with rapid trend toward the adoption of one of only five days. Yet many banks with the feeling that a service should be rendered their depositors keep their banking houses open special evenings and sometimes late hours on Saturday afternoons also. Is it not worth considering whether this does not come under the heading of unprofitable service, using whatever measure we may, be it financial, good will, advertising, increased deposits, or what not? There was a time when workers in general were paid on Saturday, usually late in the afternoon. Perhaps there was some profitable service rendered in those days in making it pos-

sible to deposit part of the wages before opportunity offered to spend them over the week end. Today, however, payrolls are so arranged that almost every day is used. But, you say, the records show that taking the country as a whole, large sums of money are deposited at these overtime or after hour periods. True, but have we ever stopped to figure out how much of it would be deposited during the regular banking hours if these special times were not available? Probably we would find that comparatively little of it would be lost. This being the case, it is hardly fair to argue that we profit to the extent of the deposit if we had received it in the regular course of business anyway.

CLUBS

Let us turn to some services which we might offhand brand as unprofitable, but are at least more debatable than some already pointed out. Take the Christmas Club, Vacation Club, Tax Club, and so forth, for instance. Admittedly it is difficult to determine the cost of this type of business. Most banks with such clubs pay interest on the deposits, few less than 2%, and some 3% and even more. In banks where the clubs are large the cost can be figured with some degree of accuracy. It is more difficult where the work is spread among persons who have other work assigned to them also. Whatever way we figure it, I think most of us agree that there is little if any profit in the deposit itself. Especially is this true if we take into consideration the bother of handling, proving, and distributing, and the consequent strain on the nerves and vitality of all concerned. However, it

would be unfair to dismiss these clubs as unprofitable services without taking into consideration other traceable results. One of these is the tendency in recent years for some of these depositors to take all or part of their accumulation and deposit it in a savings account. The extent to which this is done of course determines whether the unprofitableness of the club itself is offset. I understand that the experience of all the clubs in the country is that at the present time about 20% is returned to savings accounts.

THE RADIO

The radio has come into general use within the last few years. Some banks use this method to encourage savings or as a medium for educational propaganda to warn people against swindlers. The cost of a radio broadcast runs into pretty sizable figures on even a small station. There is no doubt but that this is financially unprofitable to the bank even though it is a distinct service to certain people. But while it is true that little if any direct money returns can be traced to a service of this kind, it may be that deposits are increased by sums which would otherwise be withdrawn to be invested in worthless "securities." Taking all things into consideration (which would include advertising value as well as the other things mentioned) it is not quite so easy to decide whether to classify it as unprofitable or not. The same is true of several other plans; the coin bank is an outstanding example. You say the cost of the banks is little. That is true. A good deal of small change ultimately finds its way to the bank through this medium. It does, how-

ever, take a good deal of time of the clerks to count the change and make the necessary entries. This sometimes results in dissatisfied customers who are kept waiting in line while the banks are being handled.

KEEPING THE DEPOSITOR'S PASS BOOK

The objection that the practice of keeping the depositor's pass book is an unwarranted service is often heard. Perhaps it is. It is considered by some examiners quite undesirable to allow the banks to have access to both their own records and the depositor's receipt, as represented by the book. But is there not another service which has a direct bearing on the question of profitableness in keeping a pass book? I refer to the arrangement for accepting deposits by mail. If it is the practice to allow customers to mail in deposits, and if it is required further that the book be presented when deposits are made, as a matter of dollars and cents it might be more profitable to keep the books at the bank rather than return them each time. It is the practice of most banks when returning savings pass books to send them by registered mail. This is expensive. Suppose a customer is systematically saving \$1 a week and mailing it in. The cost to the customer of mailing in the book each time would be out of proportion to the value of the deposit and the task of and expense to the bank of returning the book by registered mail each week would probably show the whole account (unless it were a particularly large one) a loss.

But time would not permit, even though the desire were present, to consider every service separately and

weigh it. Rather it should be left for the period of open discussion so that the services in which this particular gathering is most interested may be discussed. It is sufficient to say that a complete list of services rendered by banks would be a very long one. From some of them a profit is derived. In all fairness, however, we should not condemn all services that do not show a profit. The things mentioned specifically have been confined almost entirely to the savings end of the bank's business. Little has been said about those services which fall within the scope of the commercial, trust, and securities departments. Time could well be used for a discussion of the question as it relates to them, but would properly come before another group.

"THE LABORER IS WORTHY OF HIS HIRE"

Let me remind you that profitable is not a selfish word, but is a recognized business word. "The laborer is worthy of his hire" is just as true when applied to a corporation as to an individual. Undue profit should not be tolerated. The business that is most entitled to the word successful is that one which is established on a firm basis of honest dealing, public consideration, and service in its field. So organized and operated, both it and those it serves can find mutual profit. If full value is given in return for the trust and confidence of those who are served, it will be met, on the part of the customer, by a willingness to pay for such services as are beyond the ordinary scope of the business. It is not only entirely in order, but is in keeping with the recognized methods of good busi-

ness, for a bank to determine whether or not a service extended to its customers and friends is profitable. You ask your borrower if he is making a profit on all his lines and urge him to adjust his prices or discontinue those that are a drag on the earnings. It is not for any one person to determine just what measures are to be used by all banks. It is expected that there will be a difference of opinion among them as to how far we should go with services definitely determined to be unprofitable. We do know this, however, that service with profit not only benefits the bank but contributes to the good of the community as well. On the other hand, an undue amount of free service, like misdirected or thoughtless charity, has an undesirable effect on the customer, as well as losing money for the bank. After all we have a common objective; that is, the welfare of our bank and increasing its profits by producing additional business. If banks would give more consideration to these matters, we would have a better and sounder relationship between banking in general and those whom it serves, and many of the problems which now are so troublesome and irritating would be in a large measure removed.

Discussion

THE CHAIRMAN: I don't recall your mentioning the service that involves the payment on the part of the bank for its depositors of taxes and insurance premiums, and many of these other minor matters, Mr. Chambers.

MR. CHAMBERS: I think if I had to answer yes or no, I should say that they were unprofitable. I think our experience has not been dif-

ferent from that of other banks in the country. We avoided this type of business as long as we could. Some time ago, in all fairness, due largely to outside pressure, we undertook a plan of that kind with the glowing prospectus in hand that we would have large savings deposits and a great many customers. Our experience has been that many of the people did not keep up their payments. Those who did keep them up did so just to the extent of paying their premiums. From our narrow vision of it, they are unprofitable, because of the way most of them are run.

The bank examiners in the State of Massachusetts have taken a definite stand regarding holding pass books, and from the auditing point of view they have asked the mutual savings banks to cease the practice immediately and return the books. That does not apply to the commercial banks which want to do it. We hope all the mutual banks will return the books and then we will have them.

MRS. M. E. BONHAM (Security Savings Bank, Riverside, California): Do you give receipts for the pass books when you keep them?

MR. CHAMBERS: I think not. We may in the main office, but we do not in the branches.

THE CHAIRMAN: Of course you raised this question of profit. As far as the title of the subject is concerned, it is true that it is a dollars and cents profit. Of course, a great deal of profit or benefit accrues to the bank through good will. Isn't it a question of self defense as between the different banks? Aren't some banks led to do things they do not really wish to do on account of their neighbors doing something? Is that not quite true?

MR. CHAMBERS: I thoroughly

agree with you. I referred to it here in my talk as keeping up with the Joneses. That is exactly what I meant. What is true among the commercial banks has become largely true among the savings banks. But I rather think that the mutual savings banks would not be so deep in free services as they are today were it not for the competition offered by the commercial banks with savings departments. Most commercial banks offer any client of theirs the full service of the bank, so of course when a savings depositor comes in he has at his service the credit department, or anything else he wants. It has been largely, I think, to meet that, that you find your mutual savings banks in.

Let me say this: There is no doubt about our being in it. We are all in it whether we are savings bankers or commercial bankers. I think the question is, how are we going to get out, because we must get out of some of it.

THE CHAIRMAN: I quite agree with you. We have the lion by the tail now, and we don't know how to let go of the thing.

EDWIN V. KRICK (American Trust Company, San Francisco): I should like to raise one point here. Out in our part of the country we are faced with this problem, and I think it is pretty true all up and down the coast in those banks that have both savings and commercial accounts. A customer has a savings account and leans on that or uses that as his entrance card to all sorts of free services, including a checking account which is very active and very small.

Did you find in your investigation or check-up whether that problem is current throughout the United States?

MR. CHAMBERS: It is a very real problem with every bank, Mr.

Krick. There is a tendency on the part of commercial banks, particularly in the last two or three years, to analyze more carefully the profitability of their accounts. In so doing they have run across a great many active accounts which are being carried at a loss in the checking department.

In our particular case, and I think we are only representative of many banks in the East, particularly larger ones, we are refusing to allow a savings account to carry a checking account. If it shows a loss we get the customer to transfer from the savings enough for the balance to carry, or make a service charge for whatever amount it may be. We have a service charge rule in Boston of one dollar under \$300. If we find that the account is running at a loss with tremendous activity, costing us two dollars or three dollars a month, we do not hesitate to charge the customer for that service, and charge enough to show profit to ourselves. We do not allow him to lean on his savings account.

MR. KRICK: In many institutions where the clearing house does not control, banks hesitate to affix any charge against the savings, or make any requirements there whatever.

MR. CHAMBERS: You say that most of the banks through fear hesitate at least to take the question up with their customers. What are you going to lose if a customer draws out a savings account on which you may be earning two dollars or three dollars a year, and at the same time draws out the checking account on which you are losing ten dollars or fifteen dollars a year? That is money in the hat, isn't it?

MR. KRICK: That is very true. I do not know how it is in other parts

of the country, but there is a strange psychology among the contact people in the bank. We operate a branch bank, and we find it very difficult in many instances for us to sell our branch officers and branch tellers on the idea that they should talk freely with the customer and give him the facts. They are afraid of offending him and losing the account. They do not stop to realize perhaps that that particular account is costing the bank money. As a result, they are afraid to make the move because of the good will. They are afraid the accounts will go to the building and loan associations. This particular city that I speak of is a hotbed of building and loan associations, and they are afraid they are going to lose their customers to the building and loan associations.

I believe one answer is the matter of education of the public by the banks to get them to understand. I think it has to be done, not wholesale but over the counter individually.

ROLAND H. FREITAG (The City Bank, Milwaukee): You mentioned that when the account shows a loss you do not hesitate to make a charge for the loss and, also, add a small profit for yourself. May I ask what you consider a fair profit?

MR. CHAMBERS: I think that is a fair question. It is not so much what we consider a fair profit, but how much of a profit the deposit as a whole shows. It varies in different banks from 1% to 1½% on the gross deposit.

Should we find we were losing, let us say, for example, eight dollars a year on an account, we should not hesitate at all to put on a one dollar per month service charge, thereby giving us four dollars profit, which is small enough.

When we go to the customer, the first thing he does, as Mr. Krick says, is to say, "I will withdraw my account." We say to ourselves, "All right, Mister, if you pull out, we make eight dollars; if you stay in, we make four dollars." Of course, we do not say that to him.

DALE TUSSING (Security First National Bank, Los Angeles): About the charge for cashier's checks, do you make a charge in your locality and, if so, what is the rate of charge?

MR. CHAMBERS: Frankly, it is not quite the problem with our particular institution that it is with some others to which I referred. We make a charge on the small cashier's checks, which is the usual run of cashier's checks in the savings department, of ten or fifteen cents, if we make any charge at all.

We have come to the conclusion that a customer who has a good savings account, let us say \$100 or more, which is good for a savings account, who wants to pay two or three bills a month, causes us no more trouble and not much more expense by using cashier's checks, because we are not paying him the interest on the funds anyway. He is drawing it out between interest periods. As long as the privilege is not abused, we would not question the drawing of four or five checks a month.

A few days before I left, one of

my branch managers was telling me that a man with a small account, something like \$35, handed him a list of twelve names and told him to draw cashier's checks. Our managers have a little different schooling. He said, "We will draw two for nothing, and charge ten cents for the rest of them." He drew the two and did not pay us the ten cents.

THE CHAIRMAN: Mr. Krick raises the question of losing these decidedly unprofitable accounts to the building and loan associations. We might solve this next subject by transferring to the building and loan associations all these accounts that are non-profitable, that the banks do not want, and that might automatically, as time goes on, drive some of the building and loan associations out of business.

This building and loan association question, of course, is quite important in many of the states. Several years ago I learned that there were a great many such associations in Baltimore, and then I learned that there were something like 1700 in the city of Philadelphia.

In New York state we have no such number, or no such worry or trouble, but surely in the state of Maryland and in the state of Pennsylvania, it is a problem. I learned it was also quite a problem in the state of Ohio and in Cincinnati.

Savings and Loan Associations versus the Savings Bank

By RALPH G. HOLSTE

CREDIT MANAGER OF THE CENTRAL TRUST COMPANY, CINCINNATI, OHIO
Address before the Denver Departmental Conference

Mr. Holste explains the value of savings and loan associations in these words: "They have accomplished great things in the promotion of home ownership in this country and have thus played no small part in the prosperity we have so long enjoyed. Many of them are continuing to operate as they were originally intended to operate. They still have a large field for future service, and their method of financing the building or purchase of homes is one that I do not believe the savings bank could or would care to duplicate."

But he feels very strongly that such associations should be made to adhere to their original plans and purposes, or, if they continue to operate as mutual savings banks, they should be subject to the same restrictions and taxation laws as govern the operation of savings banks. At present the savings bank, with its many restrictions which do not apply to savings and loan associations, cannot possibly compete with such institutions as to rate of interest.

SAVINGS and loan associations and savings banks came into existence during the latter half of the eighteenth century. Both were originally mutual associations managed by philanthropists without compensation, for the good of the community. The former were established to encourage home ownership among the industrial wage earners and the latter to promote thrift among this class. Both had a somewhat different objective in view, but as they were securing their funds from the same source, it seemed inevitable that they would ultimately conflict.

HISTORY OF SAVINGS AND LOAN ASSOCIATIONS

The history of savings and loan

associations in the United States dates from about the year 1814. Industry began its real growth in this country after the War of 1812, and as industry expanded, wages increased and the number of wage earners likewise increased. As there was no way for these people to invest any of their surplus wages, they began to spend lavishly and recklessly. Gambling and speculation flourished. In time savings and loan associations were established to encourage this class of people to set aside certain regular portions of their weekly incomes for the purpose of accumulating enough money to purchase or build a home. Savings banks were established at about the same time to promote thrift and to encourage the building up of a financial reserve.

The original savings and loan associations had as their sole objective the promotion of home ownership among their members. The first of these associations were of the terminating type. Their membership was limited to a definite number, and no new members were admitted after the quota had been reached. Members admitted after the association had been in operation were required to pay up back dues accrued to the date of their membership. After each member of the association had acquired a home and liquidated his mortgage to the association, the organization was dissolved.

Later on, the continuing type of association was established, with new members being admitted from time to time and no definite membership limit. The running stock method was strictly adhered to in securing funds. Each member subscribed to a certain number of shares and paid a stipulated amount on each share each week until the amount subscribed for was fully paid. Dividends on the stock were not paid to the subscribers but were credited to the respective members accounts, thus shortening the length of time required to pay for the subscription. Upon the failure to make his regular weekly payments, the member was subjected to a fine and no withdrawals were permitted until such time as the subscription was fully paid.

Eventually, however, many associations in order to increase their loanable funds, adopted the policy of paying withdrawals upon thirty or sixty days notice and accepting money on certificates of deposit. These features proved quite attractive and the resources of these associations increased rapidly.

"FAST WITHDRAWAL" SAVINGS AND LOAN ASSOCIATIONS

Today we have with us the "fast withdrawal" savings and loan association, open six days every week and maintaining regular banking hours. They receive deposits in almost any amount on any day during regular business hours and pay withdrawals on demand upon the presentation of an order over their counter. A great many other associations which are open only one night a week are operating in the same manner. They are literally mutual savings banks operating under the freedom of savings and loan association charters.

The first savings banks in this country were mutual associations operated and managed similarly to the savings and loan associations. They were established for the sole purpose of promoting thrift among the wage earners.

Industry in the United States during the early part of the nineteenth century was confined largely to the East and, consequently, the savings banks of the nation originated there. There was little need at that time for savings banks throughout the purely agricultural West and South. It was not until industries began to spread out to the other sections of the country that there was a need for savings banks, and when this time arrived the field was developed largely by commercial banks already established in these sections and by stock savings banks.

I am not familiar with the ability of a mutual savings bank to compete successfully with the modern savings and loan association, but it appears that they would be in a little better position to compete with the 5% or 6% interest rate paid on

money on deposit with savings and loan associations, because the earnings of a mutual savings bank are available for distribution to its depositors and they do not have to earn dividends on capital stock.

WHY SAVINGS AND LOAN ASSOCIATIONS PAY HIGH INTEREST

It appears improbable, however, that even a mutual savings bank could afford to pay as high a rate of interest as a savings and loan association. It has been fairly well established that a first mortgage on improved real estate used for dwelling purposes in which the owner has a substantial equity offers a maximum degree of safety to the principal and yields a return of from 1% to 2% greater than a bond or other form of investment offering the same degree of safety.

Savings banks cannot loan more than 50% of their savings deposits on first mortgage real estate security. They are required to carry a cash reserve of not less than 3%. The remaining 47% has to be invested in high grade marketable securities which usually yield from 1% to 2% less than real estate first mortgages.

Savings and loan associations may and frequently do loan 100% of their deposits on real estate first mortgages. They are not required to carry a cash reserve; they have no dividends to pay on their capital stock and, consequently, they can afford to pay a rate of interest that cannot be met by savings banks.

The ability of savings and loan associations to loan 100% of their deposits on long time real estate mortgages and yet continue to pay withdrawals on demand is due mainly to

two things. The plan for liquidation of their mortgages requires regular weekly payments of both principal and interest; this causes a steady and predetermined flow of funds into the association. In addition to this, the regular weekly payments of subscriptions to capital stock by those who have not borrowed further, adds to their weekly or daily receipts and they are thus in a position to meet any normal demands for withdrawals. In times of abnormal demands for withdrawals, the association usually has a connection with some bank in the community which will loan them the necessary funds on their straight note, bearing a rate of interest usually not more than the rate the association is paying on its deposits.

LOANS FROM BANKS

By making loans of this nature the banks in many communities are directly aiding the savings and loan associations to compete actively and successfully with them for the savings deposits of the community. Loans made to savings and loan associations are not to be condemned in their entirety and even loans on association pass books are sometimes justifiable, but they should be made only after careful consideration of the purpose for which the loan is being made.

In addition to the higher rate of interest paid on savings and loan association deposits, the income from such deposits is exempt from the Federal Normal Tax to the extent of \$300 while the income from money on deposit with a savings bank is taxable in any amount.

In Ohio the capital stock of both savings and loan associations and savings banks is subject to taxation.

However, the savings banks, having issued stock certificates, are paying the full amount of the tax on the value of their shares, while the capital stock of savings and loan associations is taxed only when voluntarily reported by the owner of such stock. Needless to state, the larger portion of this stock is never returned for taxation.

Savings and loan associations are not to be condemned in their entirety. They have accomplished great things in the promotion of home ownership in this country and have thus played no small part in the prosperity we have so long enjoyed. Many of them are continuing to operate as they were originally intended to operate. They still have a large field for future service, and their method of financing the building or purchase of homes is one that I do not believe the savings banks could or would care to duplicate.

It appears essential, however, that one of two things should be brought about. The savings and loan associations should be made to adhere to their original plans and purposes or, if they continue to operate as mutual savings banks, they should be subjected to the same restrictions and taxation laws as govern the operation of the savings banks.

Discussion

THE CHAIRMAN: I understood Mr. Holste to recite some figures of 50% of savings bank funds that may be invested in mortgages, and 3% cash reserves maintained, and 47% in bonds. I assume that those are the Ohio state laws. We are here from the Pacific to the Atlantic Coasts, and each state has its own

peculiar law as far as percentage of investments is concerned.

Before we start, I should like to ask Mr. Holste how many savings and loan associations there are in the city of Cincinnati or the state of Ohio.

MR. HOLSTE: In Cincinnati we have more than 300 as compared with thirty-five banks.

THE CHAIRMAN: You can see that the savings and loan associations in Cincinnati run almost ten to one in comparison with the banks. It is a big problem there as it is in the other two cities I mentioned, Philadelphia and Baltimore.

NORBERT BOUVIER (Bank of America of California, San Francisco): On the Pacific Coast, the Pacific Loan Association advertises 6% on its deposits. The advertising is misleading, of course, and I believe they get some of their business because of that fact.

Also, don't you think it would be a good suggestion for the bank to advise its customers when they have surplus money, \$10,000 or more, that it will help them invest that money and get better returns?

MR. HOLSTE: I do not know that I can answer that authoritatively, except that I believe that has been tried out by several savings banks much to their dismay, inasmuch as they have educated some of their customers to invest their money in better forms than savings deposits, and they find that they are decreasing their own savings accounts by educating their depositors along that line. Probably somebody else in the group is more familiar with that than I am.

THOMAS H. O'NEILL (Bowery Savings Bank, New York): A great many of our depositors have reached the limit of \$7500, which is the legal

limit in New York state. They want to get a higher rate of interest, and one of the safest things we have in New York City is a guaranteed mortgage certificate. It is part of a mortgage issued by the mortgage companies. It is against a mortgage, and you can buy \$10,000 worth or \$100 worth. It is also guaranteed by the surplus of the mortgage companies, and some of them run as high as \$30,000,000 or \$40,000,000 in surplus. That is one of our outlets for people who have reached the limit in savings banks.

V. J. GOODRIDGE (The Dollar Savings & Trust Company, Youngstown, Ohio): In the larger industries through the Pittsburgh and Mahoning valley districts, sheet iron and steel plants, such as the Carnegie Steel Company, and the Youngstown Sheet & Steel Company, which employ thousands of men, are very consistently educating their employees to buy their own stock, particularly the Carnegie Steel Company. They pay them five dollars a year extra bonus for carrying it for two years, and if they carry it for five years they get an extra five dollars in addition to the bonus previously paid and the dividend accrued. That plan is carried out by the General Fireproofing Company and the Tuscon Steel Company, which employ 25,000 or 40,000 men.

In addition to that, we have this building and loan competition that pays 5½% on deposits. So you can see the position the savings banks are in through the Mahoning Valley and Pittsburgh districts, because this same condition goes clear through from Cleveland to Pittsburgh in the educating of employees.

I might add to that list the Ameri-

can Telephone and Telegraph Company that is putting on a very strenuous campaign of selling stock. The Standard Oil Company of New York, which controls several gas utilities, is doing that and paying extra bonuses. That is taking out of the banks the old line savings accounts and it is a real problem in our district.

I can run back in my mind fifteen or twenty years when the savings accounts were gradually going along. That condition is entirely changing now. These old accounts are gradually disappearing. These folks are being educated to the fact that their money is worth more money to them and that they are entitled to more; they are putting it in high grade securities—the biggest national and international concerns—that are earning high rates; there is a definite trend toward a change of that character.

That is something in which we are very much interested. I should like to hear from some of the rest of you who run into that same condition.

I might say we organized a plan in our community to combat the building loan competition which has held it down somewhat. Possibly some of you recall the talk Mr. Adams made at the Detroit Convention, I believe, regarding the investment situation, by which we accept deposits and pay 5%, and invest the money under the same rules employed by the building and loan companies. We have operated that department now since 1925, and, surprising as it may seem, we have held our own in stopping the flow from our bank to the building and loan association. In our regular savings, though, we have not transferred over to the 5% as much as we thought we would. We have possibly \$11,000,000 in this 5% de-

partment now, and possibly \$11,000,000 on which we are paying 4% which is the going rate through Ohio on regular savings.

THE CHAIRMAN: As I understand it, what you have virtually done is to create a building and loan association inside of your bank. Is that quite true, and is it a profitable department?

MR. GOODRIDGE: Yes.

MR. O'NEILL: With the mortgage certificates you tie your money up for three or five years, the term of the mortgage. If you want your money back, they will give it back but you lose 1%, which brings you back to where you are in the savings, and we pay $4\frac{1}{2}\%$.

FRED M. GOODWIN (Peoples Savings Bank, Providence, Rhode Island): I should like to ask the speaker the mortality of the building and loan associations. Have many of them become insolvent?

MR. HOLSTE: We had quite a bank failure in Cincinnati just before I left for the convention which might bring out that point. There were some \$8,000,000 in savings deposits. A couple of days later one of our building and loan associations came out in the newspaper with the advertisement: "This association has been in existence for some forty-odd years and has never failed to pay on demand."

In our particular section of the country there have been very, very few insolvencies among the savings and loan associations. In Cincinnati I cannot recall when the last association became insolvent. I cannot say the same thing for the savings banks during the same period of time.

MR. GOODRIDGE: I might add that we have one large building and loan company now in financial diffi-

culties. Just what the outcome will be, we do not know. We do have one of the largest building and loan companies, and the most ably managed there, The Home Savings and Loan Company, with some \$42,000,000 or \$43,000,000 of deposits. It is a well managed and exceptionally strong institution.

The people in our district do not consider building and loan companies other than banks, and they are called that by the general run of folks. This matter of educating the people as to the difference between building and loan companies and banks is something to which they do not pay any attention. They say, "They give us $5\frac{1}{2}\%$; why can't you do it?" That is as far as you get.

I think the situation will clear up now that money rates are down and conditions have been changing considerably. Personally, it looks to me as though the building and loan companies are going to be in for hard times for a while.

THE CHAIRMAN: As I understand the picture in Cincinnati, the building and loan associations are virtually the same thing as the mutual savings banks of the eastern states.

MR. HOLSTE: Many of them are. We have some of the original type. We have many of them that are really operating as mutual savings banks.

THE CHAIRMAN: We have with us a director of one of the building and loan associations in the state of New York, as well as a president of a savings bank. Perhaps he would like to say a word on the subject of building and loan associations.

Prior to your coming in, Judge Richards, I told the gathering that in the metropolitan area in New York

state, at least, we savings bank people do not give much thought to the building and loan associations and do not feel or fear competition from them.

JUDGE EDWARD A. RICHARDS (East New York Savings Bank, Brooklyn, New York): I think that while that is true, we may be, from now on, in for a little more competition than we have had, for, as you know, the building and loan associations have secured the right, each to open a station to transact business in its own city.

I am a director, and have been for many years, of a building and loan association in New York. The building and loan association law makes a distinction between classes of shares. I do not know whether that is true in other states or not, but on savings shares they may pay not less than 60% nor more than 90% of the amount they pay on instalment shares. The building and loan association of which I am a director has only instalment shares.

The distinction between instalment shares and savings shares is this: You may come into a building and loan association and agree to buy a certain number of shares and pay for them on the instalment plan, so much a week. We know that when money is put into a bank or into a building and loan association weekly there is a large part of it that does not, for a considerable time, draw interest because most building and loan associations in New York pay from the first of each quarter.

The savings shares are those for which the subscriber comes in and pays whatever amount he cares to and may not make any other payment or withdraw as in a savings bank. Our law requires building and loan associ-

ations to pay on the savings share—that is, the amount that is put in there and left there without being touched—not less than 60% nor more than 90% of the dividend paid on instalment shares. On these shares many associations pay $5\frac{1}{2}\%$.

It is true in New York, as in other states, that building and loan associations by and large are conducting a savings bank business. Many associations advertise, and put up signs on their buildings that deposits made on or before a certain date of the month draw interest from the first. Perhaps because I am a lawyer, and perhaps more because I am president of a savings bank, I call attention to the fact that building and loan associations are not permitted by law to receive deposits. Only banks may receive deposits. Building and loan associations sell you stock or shares which you pay for in instalments. The general public however does not understand the distinction.

I believe there is great danger in permitting building and loan associations to operate as savings banks without the control of investments. These associations may loan 100% of their assets on bond and mortgage and frequently borrow from the commercial banks in order to meet the payments they have to make on building loans. Those of us who have gone through financial crises know that mortgages are not liquid investments. It takes only a little to shake the faith of people, and when they come around and are told, "You can't have your money right away; you will have to wait and be put on a list and get your money in regular turn," which is as the law provides in cases of these associations, some of them, I think, might slide pretty fast.

It is a fact, as has been suggested by the speaker, that in New York as in Ohio our building and loan associations have had a very, very good record, but I think they require more regulation in this respect.

GEORGE SCHRAFFENBERGER (Brighton Bank & Trust Company, Cincinnati): May I give you some of the experiences we have gone through in the last ten or twelve months?

The building and loan associations of Ohio are allowed to borrow 20% of their assets. They have worked the banks to the king's taste and borrowed almost up to that amount as a continuous loan. Around June or July of last year the banks got together and insisted on raising the rate. They were then paying 5% for their money. They insisted on raising the rate to 6% and absolutely refused to let the building and loan associations have any money whatsoever. I am sure that I might say this, though, that the banks in Cincinnati are like banks in all the other states. They will agree on something but somebody hands it out here and hands it out there saying, "Don't tell everybody about it." What happened is that the associations practically had to quit making mortgage loans. They hadn't the money to make mortgage loans. They needed all the money coming in for withdrawals and to take care of their other needs. Quite a few associations begged banks, and more or less got on their knees to ask the banks, to assist them, to let them have the money to pay their dividends. They hadn't made any accumulation or preparation for the dividends, figuring that when the time came they could go to the banks as they had always done.

We have cleared up the situation quite a bit, and the building and loan associations appear grateful to the banks because the price of real estate has gone down in the last few months. I think they feel grateful that we have held them down. But I also believe that the associations have seen that the banks are not there to be played with any more, and they are going to operate their building and loan associations strictly on a building and loan association plan. In other words, when they have the money to lend, they are going to lend it; they are not going to come around to their banks and ask them for money. I can speak very authoritatively on that because the bank with which I am connected has some thirty-odd building and loan association accounts. When we put the clamps on them they sure hollered.

So I do believe there is a general idea that building associations appreciate what the banks have done for them in the last few years, and they also appreciate what the banks have done for them in the last ten months in holding them down and absolutely refusing to let them have money to make loans.

I believe that is one step the banks of Cincinnati have taken to help themselves out of a really grave situation. Naturally, people came in for a while and wanted to withdraw their money. The associations gave all kinds of reasons: "The banks won't let us have money any more." The person wanting to withdraw would say, "I am not borrowing from the bank; I am depositing my money with you." Then they would say, "We can't borrow from the banks and we can't let you have it." The associations are learning that they must depend on themselves.

Making Your Customer Feel Welcome

By DALE M. TUSSING

ASSISTANT MANAGER OF THE SEVENTH AND GRAND BRANCH, SECURITY-FIRST NATIONAL BANK OF LOS ANGELES, LOS ANGELES, CALIFORNIA

Address before the Denver Departmental Conference

Mr. Tussing's suggestions for making the customer feel welcome are simple, but they go to the roots of the matter. He feels that the relation of the bank to its customer must rest on a foundation of true consideration and sincere courtesy toward the customer.

It is usually possible to soothe an irate customer if one has sufficient patience and tact. Mr. Tussing tells an amusing story of an angry German who went raging to the vice president of the bank. When the vice president's reply was, "Now I am awfully sorry about that; just what can we do to make it right?" The customer said in a surprised tone, "Vell, when I talk it, it don't seem so damn bad."

Mr. Tussing feels that there is nothing he can suggest that will prove more valuable to us through life, and help us more in making our customers feel welcome, than the observance of the Golden Rule.

DO you know the president of your bank? Have you ever talked with him? Do you know his character and personality? Do you know his views on life and business? You must know him, for after all your bank—his bank—is but the reflection of his character and his personality; for his thoughts permeate and control the bank through the other officials and employees. The acts of each are taken to indicate, and reveal, the policy and attitude of the bank toward its customers, its friends. Whether a customer feels welcome, therefore, will depend on how nearly the treatment he receives approaches his idea of friendship, courtesy, and justice. A customer will base his opinion of the bank upon the friendliness, the courtesy, and the fair deal-

ing of those with whom he comes in contact. But this ability on the part of officer or employee to make the customer feel welcome has not, nor can it have, its origin alone in the knowledge and training which he has acquired in his banking experience. It is more deep seated. It goes back to the days at his mother's knee where he learned those precious lessons of honesty, justice, kindness, self-control, and consideration for the rights of others. These virtues must have been the compelling force in the development of the character of the man who today guides the destiny of your bank.

While there is a rule by which we can accomplish the subject under consideration—making the customer feel welcome—I would not presume, nor intimate, for a moment, that any with-

in the sound of my voice do not know, or are not imbued with, those things necessary to make a customer feel welcome.

You would cordially receive the customer with a friendly attitude, treat him with courtesy and kindness, and in so far as it is possible, give him the service he seeks. This would seem to answer the question, but our efforts do not always accomplish this. Our plan is correct, but it is not always the plan, but the man who is behind it that is responsible for its success, and while he has a well defined ideal and concentrates his energy on this ideal, he may fail in his purpose, but he is far richer for having tried.

EACH BANK HAS A DIFFERENT PERSONALITY

It is said (but most unjustly) that a corporation has no soul. That statement must not go unchallenged, for I defy anyone to show me where he can receive from a quasi-public servant a finer expression of sympathy, more helpful encouragement and more sincere and reliable counsel than that given by our banks. The public must know that it is not the concern of the bank only to make profit for itself, but to do that which will profit many.

Every bank advertisement, everything that a bank does, everything that its officers and employees do in connection with its business, indicate its character. A bank's character is, after all, what goes out and brings in the business.

Why does a person selecting a bank walk by several and select a particular one? All offer practically the same service, and as to method and operation, are almost identical; for

each bank adopts the good ideas and systems of the others; but they cannot adopt each other's personality or acquire the other bank's atmosphere. It must be because that particular bank has been recommended by a friend, a customer, because of its reputation, or by the attitude and character of its personnel. It is the human element of that bank, its atmosphere, its personality that controls its destiny. Mr. Charles M. Schwab when asked what he would do if his steel properties were destroyed by fire, said: "I would not even figure them as a loss as they could all be replaced in time, but if some catastrophe should destroy at one fell stroke the entire personnel of our organization, I would then consider myself a ruined man."

In selecting a bank, staying with it or leaving, the customer's choice is based not on its merit, but rather on its merit as seen by him; and he comes, stays, or goes, as he is influenced by the character of the bank as shown by its personnel. Therefore, in selecting employees, it is of the utmost importance that they be of the type that can and will properly convey to the customer the individuality of the institution. It is apparent, that unless he be of the type to meet the public, in all fairness to himself and the bank, he should certainly not be employed.

THE FLOOR MAN

Let us now look inside the bank for a moment. The first person with whom the customer has contact will be the floor man, or bank officer. This meeting will constitute the customer's first impression of the institution. Therefore, it should be one of cordiality, businesslike and not over-

done. The floor man should make every endeavor to remember the customer thereafter and, if possible, call him by name.

On my first trip to New York, following the Cleveland Convention, I was accompanied by the vice president and cashier of my bank, Mr. Smock. We called at the Chase National, one of our correspondents, to pay our respects. Upon entering we were met by a most courteous floor man who inquired if he might help or direct us. We presented our cards, and excusing himself for a moment, he presented them to the cashier, Mr. Holly. We were then invited to Mr. Holly's desk, visited for a short time, and left. At this point please note that Mr. Smock's name and my own are rather unusual. Two years later, after the Baltimore Convention, I visited New York with my wife and again called at the Chase National to pay my respects to Mr. Holly. We were met by the same floor man in the same courteous manner, and to my great surprise, he proffered his hand with the greeting, "How do you do, Mr. Tussing? How is everything in Los Angeles and the Security Bank? Is Mr. Smock with you?" I told him he was not. He very kindly took us to Mr. Holly, and said, "You remember Mr. Tussing from Security Bank in Los Angeles who was here a couple of years ago with Mr. Smock." Of course, Mr. Holly did not; but he graciously said that he did. I saw many wonderful things in New York, but to my mind this example of courtesy and outstanding memory on the part of this floor man impressed me as being the most wonderful. This is proved by the fact that I mention it to you today.

It is of the utmost importance that

no definite appraisal of a new customer be made until you have sufficient facts and acquaintance with him to make such appraisal. In one of the large jewelry stores in one of our West coast cities, it seemed to be the policy, when employing a new salesman, to place him at the counter in the rear, placing the older salesman at the front of the store, thereby giving them the first opportunity to meet the customers. When a well dressed person or prosperous-looking one entered the store, all the clerks were on their toes, so to speak, and made every effort to contact with that customer, anticipating a worth-while sale. One day there entered a man poorly dressed, unshaven, and giving the impression of being of no particular importance. He had just arrived by boat from the Klondike. Immediately upon his entrance all the clerks in the front of the store became very busy arranging the stock in their cases, and did not look up, hoping that because of their attitude he would pass to the rear; he did. The clerk in the rear not being able to avoid him, greeted him courteously and very graciously offered his services. The salesman in the front were glancing slyly at him, laughing at his expense. The result was that this stranger purchased over \$10,000 worth of diamonds and jewelry. After he left, the new clerk had the pleasure of exhibiting to his fellow workers the result of his sale, and it was then his turn to laugh. This story merely illustrates that one can never judge a person by dress, demeanor, or general appearance, and no definite appraisal should be made until all the facts are known.

Let us now consider the customer who comes to the bank for the first time to start an account. He is cor-

dially greeted by the floor man who takes him to the new account department. Here he should meet one who is the acme of courtesy, friendliness, and politeness, who is quick to understand and appreciate a situation. The new account department should not be a window with bars between the customer and teller, for this situation would be ludicrous in extending a cordial welcome. It should be an open counter, or what is preferable, a place set apart where the customer may be seated at a desk, and where the conversation and transaction between him and the teller can be strictly private. Having completed the mechanics of opening the account, the new account teller should then introduce him to the teller who will handle his account. When it is evident that the customer is a person of means or business ability, or one who is likely to use several departments of the bank, the new account teller should invariably introduce him to a senior officer before permitting him to leave the bank. This, for the twofold reason that the customer appreciates the recognition, and that it gives the officer an opportunity, in visiting with him, to get facts which will materially assist the officer in handling future transactions with his customer. This means that an officer should never be too busy to meet the new customer, for, while many are but casual and passing acquaintances, it often happens that these persons become the most important customers of the bank.

SINCERE POLITENESS

The only thing a bank has to sell is service. Service in banking is a realization of an intention toward helpfulness. This calls for a dispo-

sition on the part of the entire personnel, to seek every opportunity to be of service. It follows that this must be done in a natural and polite manner. Mechanical and condescending politeness must be avoided, and flattery should be used with discretion. To inquire as to one's health with "How are you today?" and then deliberately to continue with some detail with which you are engaged while the customer tells you of his aches and pains, is far from showing the friendly interest your question would indicate. Another vain repetition which should be avoided, is continually commenting on the weather with, "It is a fine day today!" The effect of this may be that the customer will feel there must have been a lot of your tribe taken unawares in Noah's time.

All of our conversation should be to the point and based upon a sincere effort to be of service. This is equally true with the written word. Our letters should be short, definite, couched in plain, understandable language, and as courteous as possible.

Your telephone is ringing. Are you going to answer with a short and snappy "Hello?" Remember the first fellow that ever answered a phone said that. It is possible to show personality in answering a phone, and rather than say "Hello" so it sounds like a challenge, why not say in a soft and courteous manner, "This is the bookkeeper"; or "'This is Mr. Smith speaking"; or "'This is Mr. Jones' Office." After you have started right, the rest of the conversation will take care of itself. Remember, however, that the telephone is a liar, and many times what is received at the other end of the line is entirely different from what you have said, which means all conversations which

carry commitments, figures, or data should be confirmed by letter.

SMOOTHING THE RUFFLED CUSTOMER

We are bound to meet with dissatisfaction on the part of some of our customers, but herein lies the real test of our ability to make the customer feel he is welcome, and feel that he is being treated justly. No matter how angry or unreasonable the customer may be, we should use all of our tact and ability to learn all of the facts concerning his particular complaint. We must recognize in him an injured customer, whether such injury be real or imaginary, and we must be exceedingly careful not to treat him rudely or suspiciously, but rather with extra courtesy and friendliness. He needs "first aid." When he comes to you complaining, he is at the crossroads; whether he stays or goes depends on the manner in which you treat him.

Suppose, for instance, that you had returned his check for insufficient funds when, in fact, he had ample funds on deposit. He gave his check to a person or firm with whom he wished to establish a good credit. One should not be surprised when he complains of such action on the part of the bank. As soon as the facts are known, and it is evident that the bank is in error, there is but one thing to do and that should be done promptly: apologize for your mistake and offer to write to the person or firm stating that the error was solely that of the bank, and that the transaction should not in any way reflect on the credit of the customer. It should be remembered always that a customer is not interested in the detail work of the bank, and to attempt to explain an

error as a result of some detail of your organization, simply leaves in the mind of the customer a lack of confidence which may operate against you in future dealings. If you are unable to grant a loan, or other request, take the sting out of the refusal by a really sincere, adequate, and businesslike explanation of the reason therefor. This is due him, but in addition thereto, there is injected into the situation a certain element of flattery that makes a customer feel that you really consider his business valuable by reason of the fact that you have given him a personal, and not a stock, explanation, making him feel that he is receiving special consideration.

If it is a question of a charge for any service, cause him to feel that the various special services performed by the bank have a definite and tangible value and are worth paying for. Work well done deserves an adequate fee. Create in him, if possible, a feeling of pride in his banking connection, and make him realize that a properly conducted bank is the cornerstone of his community.

TWO DEFINITE EXAMPLES

There are times, but I hope in your case, not many, when a customer feels he has been wronged to the extent that when he calls to talk the matter over he is so angry that you cannot reason with him, nor will he let you talk. As an actual example, there came to the desk of one of our vice presidents, a gentleman of German extraction, who was about six feet two inches tall, with very broad shoulders and a large muscular neck. His face was red as blood, and his expression showed plainly that he was exceedingly angry. The vice president in

his usual courteous manner arose to greet him only to be met with a declaration on his part that he was mad—very, very mad—at the bank. The vice president said to him, "I am awfully sorry that you feel that way. Tell me what has happened, and let us see if we can not adjust this matter so that you will feel kindly toward us." Whereupon he talked over his grievance loud and long. The vice president sat kindly by. When he had finally finished, the vice president said to him, "Now I am awfully sorry about that; just what can we do to make it right?" For the first time in his natural tone, he said, "Vell, when I talk it, it don't sound so damn bad." I mention this to show how very important it is that we do nothing to antagonize a customer further until he has got the trouble out of his system. By using the tact which he did, the vice president saved a mighty good customer for the bank, and cemented a friendship which has lasted many years.

Again there was the case of a very good depositor becoming, as he felt, insulted by a young lady acting as a notary in the bank; this amounted to nothing more than her refusal to allow him to use her telephone. Having had a good deposit with the bank for a number of years, this refusal made him exceedingly angry and he closed his account, but made no mention of the occurrence to any employee of the bank. It so happened, however, that another customer was present at the time, saw the occurrence, and saw him withdraw his balance. Being a true friend of the bank, he wrote a letter to the president thereof telling him the story. The president turned the matter over to one of his officers for investigation, and this officer went

to see the customer personally at his home. When he made known who he was, and the reason for his call, he was not received very courteously, but instead was subjected to a very irate attack on the bank. The bank officer expressed to him his great regret that the occurrence had happened. The customer then went on to tell him that apparently the bank had grown so large that it did not care anything about the average person's account, and that was one reason why he was opposed to branch banks, or the consolidation of banks into one large unit. The officer then told him that in that respect he was wrong, for he was there at that time at the express personal instruction of the president of the bank. The customer then asked him if he meant to say that the president of the bank knew anything about his trouble, and had considered it important enough to send a personal representative to see him concerning it. He was informed that such was the case. The officer was surprised to have the customer say to him then, "Do you mean to tell me that the president of your big bank has personally sent you out here to see me about this matter?" The officer replied that that was the sole purpose of his call, and that he was there to express on behalf of the president his deep regret that the unfortunate occurrence had happened. This statement seemed to touch a responding chord, and the customer then stated that this was the first time that he had ever heard of a president of a bank being interested in any one customer to the extent of doing what he had done in this instance. He stated that he had moved his account to another bank and did not feel that he should change it at this time, but

that possibly in the future he would do so. With the request on the part of the bank officer that he continue to feel that the bank was still his bank and to make use of it whenever possible, the interview was ended. The final result of this was that a short time thereafter, this same customer came back to the bank and opened another account for \$10,000.

REAL FRIENDLINESS

We must treat our customers as friends, and our attitude toward them will be the result of our thoughts; for as we think, so we are. We are where we are today as the result of our thoughts, and will be tomorrow where our thoughts carry us, for we gravitate toward that of which we think, be it good or bad. We shall receive the exact result of our thoughts as our reward. We cannot think of how to make people happy and welcome, and how to help them in times of need, without ourselves being greatly benefited, and the impress made on our character as the result of truly trying to help our brothers will be not only for today but eternity. We travel the road of our thoughts and our life will be but the history of that road. True we pass this way but once, but as we approach life's twilight, our minds slowly but surely bring before us in review our past successes and failures together with their causes and their effects. It has been said, "Blessed is the man who hath the gift of making friends; for it is one of God's best gifts." Making a customer feel welcome in the bank consists of nothing more than making him a friend.

In the beginning I stated that there is a rule by which we can accomplish

the purpose under consideration, making the customer feel welcome. This rule is not of recent origin, nor is it of the present generation. Centuries ago Confucius was walking through the woods soliloquizing and analyzing and sizing up things in solitude. While thus engaged he was waylaid by two Chinese peasants. These men had heard of Confucius' philosophy, but they could not make much out of it, for Confucius used words beyond their limited understanding. These men, with raised clubs, halted Confucius and said to him: "Our minds are small. We do not understand the things you say. Tell us how to live. Make your story short or we will slay you. We can remember only as much as you can tell in a moment. Therefore, stand on one foot and tell us quickly what we are to do. We can remember only what you can tell while standing on one foot." Confucius stood on one foot and said: "Sing, fat, bong, lung, looy"; which, being interpreted, means "What you would like others to do to you, do to them." Thus the Golden Rule has come down to us through centuries. Although it has been attacked, like all pure gold it has endured forever. There is nothing that I can suggest that will prove more valuable to us through life, and help us more in making our customers feel welcome, than the observance of this rule. It is not theoretical, but is wholly practical; so in closing I feel that the essence of all logic, good advice and philosophy may be summed up in the following: "Do unto others as you would have others do unto you."

Discussion

A. R. LUCHSINGER (Bank of

Italy National Trust & Savings Association, Vallejo, California): I want to ask one question regarding the opening of a new account. When you find out whether the customer has a large or a small account, what do you do to insure on his return to the bank the same courteous treatment he received on his first visit? I have noticed that the man who opens the account is the one to whom the new customer will return on subsequent visits. It is often hard to move the customer along, and of course one person cannot take care of all the new customers.

MR. TUSSING: That is a very good question. What we do, as I intimated, is first of all to take the man to the particular teller or window through which his account will be handled. We go further than that. We get all the information during the course of the conversation when the customer opens a new account. You will find that as a rule he is very talkative. He has already considered you. He has given you the necessary once-over and he is in there because, first of all, he has confidence in your institution. Consequently, he is not going to be so guarded in what he says. In the course of the mechanical operation of the account you will gain from him a great deal of knowledge. After he leaves, it is our policy to have that recorded and it is passed to all the different departments and all the sources that might in any way come in contact with the man. In other words, we pass it around and we make every endeavor to have him receive the same courteous treatment whenever he comes in, because if he does not, the whole thing is a farce. You ought to be able to treat a man in a more courteous and more friendly

manner after you have met him three or four times than you did the first time.

MR. LUCHSINGER: The question I had in mind was that when he came in originally to open his account he had your personal attention, whereas on the second visit there might be many customers at the window and of course he would not receive personal attention.

MR. TUSSING: Our policy is that the man at the new account window is generally the man in the twilight zone, as that zone has been very ably referred to. He is on the borderline of becoming an officer of the bank. The very manner in which he does little things may decide whether or not he does become an officer.

GEORGE W. WRIGHT (Bowery Savings Bank, New York): Isn't that the secret of the whole thing, Mr. Tussing? By putting a man in the twilight zone, as you call it—I don't know whether I like that or not because sometimes that refers to age—haven't you solved the problem in the fact that you are setting an example to the whole force?

Several years ago a president of ours, who was a thorough master of the art of advertising, was very much upset by hearing the children crying who were brought into the bank by their parents. At that time our office, which is down in the Bowery near Grand Street, had, as now, many Jews and Italians. These people would bring their children into the bank, and for the life of us, we couldn't understand why it was that nearly every youngster cried. One of our floor men said he thought they stuck pins in them, because the floor man would take the customer and the child down to another window and

have them waited on and shunted out of the bank as quickly as possible.

It developed that this president realized that something had to be done; we are back to the time Mr. Kinsey speaks of when we were just beginning to learn that the paramount thing in the banking business in the way of service is courtesy and a kindly feeling for mankind. The president brought up the point, with the comptroller, that it might be a good idea if he got some chocolate and gave it to these little ones as they came into the bank and had them sit down on a little bench to eat the chocolate while their mothers were being waited on. He said to the floor man, "When you see one of these youngsters come in, you send that youngster back to me." One of the floor men, and in fact the comptroller, brought to his attention that it was going to take a lot of his time, but he said, "I have children of my own and I guess I know how to treat them."

These children were brought back to him and he gave them the chocolate. They sat there and ate it.

You may wonder what that has to do with the banking business and what there is in the story. That was a good many years ago. Yet within the last five years a woman came into the Bowery office and wanted to see one of the officers. I talked to her, and here is her story: "My daughter Rosie married a terrible man. He is a gambler," and I gathered from the way she talked that the man was just about an ace-high gangster. "He has taken all the money she had and now he wants her to have my account changed so that both he and my daughter can withdraw from it." I advised her not to do it. Fortunately, he wasn't around.

After she was through with her story, I said to her, "Would you mind telling me why you came in here?"

She said, "My Rosie used to come in here when she was, oh, a little bit of a girl, and she said, 'You know, mamma, when I came into the bank I used to go to that man in the bank who gave me chocolate. I was just thinking that possibly they have the same kind people there now, and I think you had better go over and see them and maybe they can help you.'"

There was the result of passing chocolate out to that little girl. She remembered it and advised her mother what to do. The gift of chocolate made such an impression on that little youngster that she never forgot it.

LEO F. RYAN (First National Bank, St. Louis): I want to ask Mr. Tussing what his opinion is on sending out thank you letters on new savings accounts.

MR. TUSSING: In my judgment, a great deal would depend on what the letter said. I think it is a fine thing. I don't think any of us has a make-up any different from mine in this respect, that we all like recognition; we all like expressions of appreciation for things we have done.

MR. RYAN: The letter I refer to is signed by the president thanking the depositor for having opened his account and inviting him to come in to see him the next time he comes in to make a deposit, make himself known, and feel free and at home.

The reason I asked that question is that we receive a good many complaints from people who have opened up secret accounts. If a man opens a secret account and the letter goes to his home and his wife opens it, sometimes in a week or ten days the account is closed out. Recently, on

account of the volume of accounts we were getting, we discontinued the letter temporarily. Now we are receiving complaints that when people open accounts they are not even thanked by letter.

MR. TUSSING: What is the objection to thanking them at the time the account is opened?

MR. RYAN: That is done.

MR. TUSSING: I think that is much better. Don't let them come in and find you don't mean what you say in the letter.

There is one bank I know of that says (and I hope no one is present here who will take offense): "Come in and shake hands with us and meet our president." One fellow took him at his word. He came into the bank and when the floor man asked him whom he wanted to see, he said, "I am here upon the express invitation of the president and I want to see him." When asked what he wanted to see the president about, he replied, "That is none of your business."

The floor man went in and told the president, and while he was very busy he said, "All right, show him in." The man came in and the president greeted him and said, "What can I do for you?"

The man said, "I saw your advertisement, 'We are just one big family,' and I just came in to shake hands with you." That was the only purpose he had, to come in and shake hands with the president. Don't tell them that you will do a certain thing for them, or that they will find a certain thing there, and have them come in and be disappointed.

MR. RYAN: That is my personal opinion.

MR. TUSSING: I think you should write letters where it has to be done,

but personal contact and expression of appreciation at the time are far superior.

Your experience about fictitious name accounts reminds me of something that happened before I left. A young lady came in and wanted to know if she could withdraw \$100 from her savings account without having it taken off her pass book. I saw the book and noticed that the husband was a party to it. I said, "What is the matter; have you been playing the stock market?" She said, "No, bridge."

MR. RYAN: That was my personal opinion about the letter. Your suggestion of making them feel at home on their first visit and introducing them to the senior officer takes care of them, and a letter is unnecessary.

THE CHAIRMAN: Our practice is to have a little booklet of about four pages, the cover of which says, "Welcome." In that little printed booklet we include a little account of what we hope will be the relationship between the new depositor and the bank, and explain in there the services we hope to render and how we hope to conduct ourselves. We deliver that inside the envelope with the new pass book at the time the account is opened.

I do believe the psychological effect of handing to a new depositor some literature or something about your institution certainly does have some weight. Old as I am, when I go anywhere I like to come back with circulars of some kind because I can sit down afterward and read them. There hasn't been a map or a booklet about a trip, even to the airplanes, lying around in the lobbies of hotels that I haven't got in my room to take

back home with me, and not primarily to prove that I was in Denver, either.

But I do believe that giving your new depositor a little something he can take home with him and read later has a good effect. When he is in the quiet of his room and opens his pass book, looks at it, and studies it, I know he will read this little welcome message, if it is not too lengthy. In a very few words, in a nicely prepared inexpensive booklet, you can convey a welcome to him which, I believe, is the next best method to word of mouth.

MR. WRIGHT: Just before I left New York, a savings bank officer called me up and wanted to know whether we had a water fountain in our bank. I said, "Yes." He said, "That is why they are coming in and asking us why we don't put one in our bank." Now they are putting in a water cooler for the people.

MR. TUSSING: I wonder if any are present who have safe deposit vaults in which they have a cold storage vault for storing ladies' furs and things of that kind.

THE CHAIRMAN: I know one person who has that in his bank but he is not present. He went out a while ago. There is such a thing. Judge Richards' bank has a safe deposit vault as well as cold storage vaults for furs. He is in the East New York Savings Bank in Brooklyn. It is run, of course, as a separate corporation from the savings bank. But in his neighborhood and in his territory, it is something that has developed far beyond even their own expectations.

ROLAND H. FREITAG (The City Bank, Milwaukee): It came to my attention some time ago that the Union Trust Company of Cleveland was making quite a success of that kind of business. You might get that information from somebody there.

Trust Functions

Some Practical and Legal Problems in Business Insurance Trusts

By RAYMOND W. HALL

VICE PRESIDENT AND TRUST OFFICER OF THE FIRST NATIONAL BANK OF
KANSAS CITY, KANSAS CITY, MISSOURI

Address before the Denver Departmental Conference

Mr. Hall quotes specific cases in explanation and support of his statements concerning the following topics:

1. Validity of an executory contract
2. Insurable interest
3. Right of corporation to purchase its own stock
4. Valuation of stocks
5. Tax liability
6. Supplemental trust
7. Rights of minority stockholders.

Mr. Hall concludes his speech as follows: "We may say, as a general rule, that where an agreement is equitable in its terms and conditions and does not violate any fundamental rule of law, it will be upheld by our courts. . . . So long as we follow the fundamental rules of law and do not attempt to add supplemental trust agreements or other matters which may cause trouble, not only to the trustee but to the parties in interest, we may safely say that this type of agreement may be made binding upon all parties."

WHILE life insurance trusts have been in existence for many years, the use of the so-called business insurance trust, to retire a stockholder's or partner's interest in a business at death, is of recent development. Banks and trust companies throughout the United States have been carrying on a campaign of education on all types of trusts, and particularly life and business insurance trusts, and in this movement there has been the hearty cooperation of the many insurance companies. This educational program has resulted in an ever increasing number of such trusts. From a recent report submitted to the Trust Company Division of the American Bankers Association, it was re-

ported that during the five year period from 1923 to 1927 inclusive, \$541,000,000 in life insurance policies was deposited with corporate fiduciaries under trust agreements. In 1928, this amount was increased by \$700,000,000 and with \$1,200,000,000 deposited during the year 1929, the total life insurance policies now under trust agreements with corporate fiduciaries should exceed \$2,500,000,000.

What percentage of this insurance is written for the express purpose of retiring stockholder's or partner's interest at death is not known. The president of one of our large life insurance companies recently said that his company, during the year 1929, named

corporate fiduciaries as beneficiary in more than 8,000 policies, aggregating about \$69,000,000 of insurance, and that the major portion of this insurance was issued for the purpose of liquidating stock or partnership interests at death. It is believed insurance for this purpose will be ever increasing in direct proportion to the energy exerted by the insurance companies and banks in educating the public, and perhaps in only a few years, may exceed the amount now issued by insurance companies and placed under life insurance trust agreements.

From these figures we must conclude that the business insurance trust is here to stay. It is not an experiment; yet the trained legal eye, searching for precedent, may find only a few cases from our courts to follow. For the most part, our statutes are silent. With the enormous growth of business insurance trusts and the use of life insurance for the purpose of establishing a definite liquid value on the stock or the partnership interest at death, we may expect in the future, many decisions to guide us, but for the present, we must rely mainly upon a few general principles of law and attempt to apply them to the facts in each case.

Many practical and legal problems are presented in the discussion of this subject.

IS SUCH AN EXECUTORY CONTRACT VALID?

Let us assume these facts in the ordinary business insurance trust: the stockholders deposit insurance policies with the trustee and enter into a contract whereby, upon the death of one of the depositors, the trustee collects the insurance issued and carried

upon his life, pays his executor for the stock, and makes distribution of the stock so purchased to the surviving stockholders. Is such an executory contract valid and binding? If it is not, then we must at once advise our insurance underwriter friends and prospects for this type of trust, that new trusts of that nature must not be created. Three legal questions are presented:

1. Is such a contract supported by a valid consideration?

2. Is such a contract contrary to public policy?

3. Is such an agreement an attempt at testamentary disposition of property?

The time allotted for discussion of this subject will not permit the citation of many authorities, and it shall not be my purpose to quote at length from any decisions, but rather, I shall attempt to give mainly, my conclusions from the cases read. On this subject, a recent case from the Supreme Court of North Carolina is of much interest and value not only for its conclusion, but for the reasons adopted in rendering the decision. It is the case of *Fawcett v. Fawcett* 132 S. E. 796. Two brothers owning bank stock entered into a written agreement whereby each brother agreed with the other, to sell to the survivor, his bank stock, at par, to be paid for in five years after his death. The contract was made binding upon the heirs, executors, administrators, and assigns of each party, and also provided for the cancelation of the contract by either party upon giving notice to the other party, in writing. Upon the death of one of the brothers, a controversy arose as to the validity of the contract and the above three questions were raised.

The Court, in holding that there was a proper consideration for the contract, said:

"Any benefit to a promisor or any loss or detriment to a promisee is sufficient consideration to support the contract. A promise for a promise is a proper consideration."

The Court, in holding that this contract was not contrary to public policy, said:

"It has often been said that public policy is an unruly horse, astride which one may be carried into unknown paths. The Courts, as a rule, will not elect to denounce a transaction as invalid on the ground it is against public policy unless the transaction contravenes some positive Statute or some established rule of law."

And so, on the third point, the court declared the agreement to be a binding one and not an attempt at testamentary disposition of property. Quoting from the decision:

". . . It has only one witness and purports to be not a will but an executory agreement. Six times it is specifically designated a contract; evidently it is a present contract presently executed, the performance of which is deferred until the death of one of the parties. In our opinion, the contract is neither void nor illegal. The instrument in question is an executory contract, not a testament."

The courts of New York, Illinois, Pennsylvania, Maine, Massachusetts, Missouri, Kansas, and many other states, have upheld contracts providing for the disposition of stockholder's or partnership interests at death, or during the lifetimes of the contracting parties. *Scruggs v. Cotterill* 73

N. Y. Sup. 882; *Fitzsimmons v. Lindsay* (Pa.) 54 Atl. 488; *Hall v. Merrill Trust Company* (Me) 76 Atl. 926; *Thompson v. Thompson Carnation Company* 279 Ill. 54. Specific performance may be granted by a Court of Equity to enforce the terms and provisions of such a contract, *Johnson v. Johnson*, 286 Pac. 109 (Kansas); *Scruggs v. Cotterill*, 73 N. Y. Sup. 882. *McKinnon v. McKinnon* 56 Fed. 409 (8th Circuit). In Rhode Island (*Ferarra v. Russo* 102 Atl. 86), and in Mississippi (*Thomas v. Byrd* 73 No. 725) partnership agreements providing for the acquisition by the survivor of the deceased partner's interest were held void because testamentary in character. These two latter cases represent the exception to the general rule, and I do not believe will be generally followed in the other states. The principles of law, announced by the Supreme Court of North Carolina, in the case of *Fawcett v. Fawcett*, supra, represent the prevailing rule and should be followed in most jurisdictions. Bear in mind however, that there are so few cases involving the modern business insurance trust that other questions may be raised in future litigation concerning the validity of such agreements; but for the present, it may be said that in most jurisdictions it is believed the Courts will uphold such executory contracts.

INSURABLE INTEREST

In planning an insurance program, the question of vital interest to all concerned is, "Who is to pay the premiums upon the insurance carried to liquidate an interest at death?" and the further question is then presented and must be considered with the ques-

tion of the payment of premiums. "Does the party who pays the premiums have an insurable interest in the life of the insured?" Generally, these premiums are paid thus:

1. Each individual may pay the premiums upon his own insurance

2. The stockholders or partners may pay the premiums on each other's insurance

3. The premiums may be paid by the corporation or partnership.

If each individual pays the premiums upon his own insurance, the question of insurable interest may not be raised, but in the event that the corporation or partnership pays the premiums, or the stockholders or partners pay the premiums on each other's insurance, then the law of insurable interest may cause difficulty. It cannot be doubted that a key man employed by a corporation or a partnership is of great value to the business, and the corporation or partnership has an insurable interest in his life; and likewise, a stockholder, although he may not be an officer or director, may be of such great importance to the corporation on account of credit conditions that either the stockholders or the corporation will have an insurable interest in his life. The real test is, will the party who is to pay the premiums upon insurance have a reasonable expectancy that he will suffer a substantial monetary loss in the event of the death of the insured? If he may expect such a monetary loss, then he has such insurable interest in the life of the insured. Business insurance trusts may not be used effectively for large corporations having many stockholders, because it would be impossible to have the cooperation of all the stockholders upon any plan of liquidating the stock, and then the

question of insurable interest, if insurance is to be used for the purpose, would prevent such an arrangement. It cannot be said that the stockholders of the United States Steel Corporation, or the corporation itself, may generally have an insurable interest in the life of any of its stockholders. Such a corporation is too large, and has too many stockholders, and the death of any particular stockholder may not, in the least, affect the business of that company.

Business insurance trusts are generally confined to the close corporations or partnerships where the interests are few and where there may be cooperation among the stockholders in perfecting the plan.

Therefore, we may say that the corporation has a right to pay the premiums upon life insurance carried on a key man or a member stockholder, if it may expect that the death of the stockholder would cause it to suffer a substantial monetary loss, and provided that the corporation, at the time of the execution of the contract was in solvent condition and had a sufficient surplus or earnings out of which such premiums may be paid. The rights of creditors must always be considered in connection with the disbursement of any funds for a purpose of this kind; so that an insolvent corporation, or one having an impaired capital and surplus may not, according to the rule in most jurisdictions, pay the premiums for insurance on the lives of its stockholders. Applying the test of insurable interest, in most cases, the stockholders in a small corporation have an insurable interest in each other's lives, and a contract providing for the apportionment of all premiums among the stockholders in proportion to the

shares held by them, may be considered as valid and binding, and does not violate any law pertaining to insurable interest.

RIGHT OF CORPORATION TO PURCHASE ITS STOCK

Two methods are commonly used in providing for the liquidation of a stockholder's interest at death. One is for the corporation to pay the premiums upon insurance and have the policies payable directly to it, and then, at the death of the stockholder, the corporation redeems the stock out of the insurance proceeds collected by it, paying the redemption price thereof to the estate of the deceased stockholder; and the other method, which is the most satisfactory from the standpoint of safety, is to have the insurance policies payable to a trustee under a properly drawn contract, and at the death of the insured, the trustee collects the insurance, purchases the stock of the deceased stockholder from his estate, paying the value thereof to the estate, and distributing the stock to the other stockholders. Under the first plan, the corporation retires the stock of the deceased stockholder, or considers it as treasury stock. The result is that the surviving stockholders have a larger value as represented by their stock holdings. But under the second method, the capital of the corporation remains the same, and the surviving stockholders' interest is increased by the proportion of the decedent's stock delivered to each.

No question is involved concerning the right of a trustee to purchase the stock of the decedent, but in some states, there may be a serious question raised as to the right of the corpora-

tion to purchase or deal in its own stock. Many states, by statute or by decision, expressly prohibit a corporation to purchase its own stock. Among the states, we find Kentucky, Vermont, Wyoming, Kansas, Louisiana, Alabama, and Tennessee, denying the right to the corporation to purchase its stock. In these particular states, it would perhaps be necessary for the stockholders to pay the premiums upon their own lives, or upon the lives of each other, and use some plan other than the plan of the retirement of the stock through the corporation. In recent years, with the development of large holding companies and investment trusts, many legislatures have adopted a rule of law permitting a corporation to purchase its stock or to deal in its stock. We must bear in mind, however, that these statutes are not retroactive, and perhaps no corporation existing prior to the date of the adoption of the law may have the right to purchase its own stock unless, and until, its charter may be amended under the new law, authorizing it to have this particular power.

VALUATION OF STOCKS

Banks and insurance companies advocate the use of the business insurance trust agreement, not only because it definitely provides for the liquidation of the deceased person's interest, but also because it provides a plan so that the estate may receive in cash the actual value of the stock held by the deceased party at the date of his death. The question of the value of the stock is indeed important, and if a bank or trust company is used as trustee, it becomes necessary that some definite plan for determin-

ing the value of the stock be written into the trust agreement.

In many close corporations, the stockholders and officers determine the value of the stock by ascertaining the book value. This, in many cases, would work a substantial injustice to the estate or to the other parties for the reason that many corporations do not carry assets at market value. The item of good will may not be carried on the books at all. This method is not the best one to use in a trust agreement.

Another plan which is often used, and which is considered fair for all the parties, is for the agreement to provide for the value of the stock at the date of the execution of the agreement. The stockholders then obligate themselves to file with the trustee, a written agreement determining the value of the stock each six months thereafter or at stated intervals. Upon the death of a stockholder, the last agreement providing for the value of the stock definitely determines the value thereof unless a period of time has expired since the filing of the last statement with the trustee, of more than one year, in which event the value of the stock is to be determined by arbitration. Under this plan, the stockholders determine the value of the stock from time to time and if they do not, or are unable, for any reason, to do so, then a board of arbitrators may decide the question, and the trustee may rely upon the action taken by the stockholders, or any action taken by the board of arbitrators.

METHODS USED BY THE BOARD OF TAX APPEALS

Other methods are used by the United States Government in deter-

mining the value of stocks. Our Board of Tax Appeals, in several cases, has used the method of allowing a fair return on fixed assets, such as real estate and securities belonging to the corporation. The interest apportioned to these fixed assets is then deducted from the average earnings of the corporation over the last five year period. The amount as thus determined represents income which may be apportioned to good will and other items upon which a fixed interest rate is not determined. This sum is then capitalized at from 10% to 15%. To the capitalized earnings on good will and other assets is added the value of the real estate and securities on which a fixed investment rate is allowed. This then represents the total value of all the shares of stock of the corporation. We then determine the book value of each share by dividing by the number of shares in the corporation. In working out this plan, it may, in many cases, be necessary to adjust the valuation for real estate and securities so as to have the actual market value instead of the book value.

The Board of Tax Appeals, in another case, decided that it would be proper to determine the value of the stock of the corporation by first ascertaining what rate on investment the average investor would require from the particular stock in question. Average annual earnings of each share of stock over a period of five years is capitalized at a rate which the average investor would require from stock in a company of that particular class.

The principal difficulty in using any formula such as has been used by the Board of Tax Appeals, is that it is not easily understood by the average stockholder. He would rather, in

most cases, determine the value of his stock, not as a result of any formula, but resulting from his own judgment and conclusions. In most cases, the plan suggested above of the written agreement between the stockholders will be used.

However, unless some formula is used for determining the value of stocks, there may be difficulty should there be any change in the capital structure of the corporation. Should the stockholders, for example, fix the value of the stock by written statement filed with the trustee, at \$200 per share, and thereafter declare a 100% stock dividend without changing the method of determining the value, then the question is immediately presented as to whether or not the fixed value as given by the stockholders in the trust agreement shall be the basis for settlement upon the death of one of the contracting parties.

A COURT DECISION

A very interesting case involving this point was recently decided by the Supreme Court of Pennsylvania (Merchants Citizens National Bank and Trust Company v. Mauser, 147 Atl. Rep. 90). The Mauser Mill Company had a capital stock of \$200,000 divided into 4,000 shares at the par value of \$50 each. The principal stockholders entered into a written agreement providing that upon the death of any of the stockholders, the survivors should, within fifteen days thereafter, purchase the shares of stock of the Mauser Mills Company owned by the decedent at the price of \$100 per share. After the agreement was executed, the company issued \$100,000 of preferred stock which was given preference

over the common stock. At a still later time, the company declared a 100% stock dividend, which added 4,000 more shares of common stock, but did not, in any respect, increase the assets of the corporation. The widow of the decedent brought suit to enforce the terms of the contract for the payment of \$100 per share. At the time the decedent died, the original stock represented only \$50 in assets. The court held that the surviving parties to the contract were not obligated to pay the double value thereof for the reason that since the contract provided for the delivery of the corporate stock at a future time, the presumption arose, in the absence of any provision to the contrary, that the parties intended such stock as was in existence at the time the contract was made. The change in the capital structure of the corporation was so radical as to relieve the surviving stockholders from the obligation of purchasing the diluted stock at the double value.

From this case it would appear that the courts will grant relief from any grave injustice which may be done by reason of any important changes in the capital structure of the corporation. There may be other changes vitally affecting the stock which might occur within a six months' period of time. For that reason, the contracting party should be advised that the agreement should be changed upon the happening of any such event so that any injustice as to value of stock may be eliminated. In view of the fact that any formula may be difficult to explain, I believe the plan of permitting the stockholders to fix the value of the stock is the best solution of this problem, provided they are sufficiently cautious to make changes in

the agreement should there be any sudden change in the capital structure.

TAX LIABILITY

If the corporation pays the premiums upon the insurance carried upon the life of a deceased stockholder, it may not deduct from its gross income the premiums so paid. When the individual stockholder pays the premiums upon the insurance carried upon his life, and his insurance is payable to some one other than his estate, then all of the insurance becomes a part of his gross estate at death subject to tax, excepting, however, \$40,000 specific exemption, allowed by the Government when such insurance is payable to named beneficiaries. If the premiums are paid by the beneficiary of the policies, then the proceeds of the insurance upon the death of the insured are not subject to Federal Estate Tax. An example of this is the payment by the corporation of the premiums upon the insurance carried upon the life of an individual stockholder, and the collection of the insurance at his death. If, however, the proceeds of the policies are payable to the corporation, then the value of all of the stock of that corporation is increased by the amount of insurance, and therefore, the value of the stock of each individual stockholder, including the decedent's estate, is increased and becomes liable for the Federal Estate Tax. Should each stockholder pay a pro rata portion of the premiums which are required to be paid on all policies other than his own, then the insurance proceeds are not subject to Federal Estate Tax. Or, if each stockholder pays his proper proportion of the premiums on all of

the policies carried, and some plan is worked out by which the corporation pays the premiums and charges the same to each individual stockholder, and if consideration is given, in determining the value of the stock, to the rate of the premiums paid by each individual stockholder, then it is believed that the proceeds from the policies, upon the life of the decedent, will not be subject to Federal Estate Tax. Again, it may be said that there have been very few rulings upon the subject of taxation of business insurance trusts. We may not be absolutely certain of any position taken except such as may be found to be analogous to some decided rules of law in respect to taxation.

SUPPLEMENTAL TRUST

It has been suggested that the insurance which becomes payable to the estate of a deceased stockholder should not be made payable to his estate, but may be the subject of a supplemental trust incorporated into the business insurance trust agreement. In other words, instead of the insurance money being payable to the estate, it may be payable to the trustee and by it invested and reinvested, the income distributed to certain beneficiaries, and the trust terminated at a definite time. This would indeed be beneficial and desirable from the standpoint of the stockholder, his beneficiaries, and the trustee. Many trust officers have not only advocated the use of the supplemental trust, but have actually approved its use.

Before approving a plan of this kind, we should satisfy ourselves concerning certain fundamental rules of law. Bear in mind that in most of the business insurance trust agree-

ments, the stock is delivered to the trustee, indorsed in blank, and the actual transfer is not made. The stockholder votes his stock and receives the dividends direct, without any participation on the part of the trustee. It may be important to determine whether or not the delivery of the stock to the trustee and the signing of the agreement, constitutes an actual passing of the legal title to the stock. If the title does not pass, then undoubtedly the executor of the decedent's estate would have the right to require the stock to be inventoried as a part of the assets of the estate, because at the death of the stockholder, the title was in him, and upon his death, became a part of his estate. Assuming that the title to the stock does pass, we have a further question and that is, has the stockholder retained such an interest in the stock during his lifetime by receiving dividends therefrom and voting the stock so that the supplemental agreement would constitute an attempt on his part to make a testamentary disposition of his property? We are aware of the large number of decisions from various jurisdictions, holding that in living, revocable trusts, if the grantor reserves too much power over the assets of the trust, it may be considered as testamentary in character, and the assets of the trust become a part of the decedent's estate. Having these cases in mind, it has been the practice of the bank with which I am associated, always to insist upon the proceeds of life insurance being payable to his executor or administrator. In most cases, there may be trouble ahead where the supplemental trust is adopted, for the reason that the executor and his attorney may consider that under the law of that par-

ticular state, they are entitled to the usual and customary fees upon the proceeds of the policies.

RIGHTS OF MINORITY STOCKHOLDERS

If individual stockholders enter into a contract for the disposition of their shares of stock at death, and pay the premiums upon the insurance, the minority stockholders have no interest in the matter. Even though the corporation pays the premiums upon the insurance, but charges the premiums to the salary or dividend account of the individual stockholders, still the minority stockholders may not complain. If, however, the premiums are paid by the corporation, and the corporation is not the beneficiary of any of the policies, or does not derive some benefit from the money thus paid, then the minority stockholders do have the right to complain and may seek redress through our courts. If the corporation pays the premiums, although it may be the beneficiary of the policies, yet, if by reason of the payment of the premiums, the capital of the corporation is impaired, then the minority stockholders may make complaint. Under the laws of most of our states, the minority stockholders have the right to inspect the books and records of the corporation at reasonable times, and have certain legal and equitable rights which may be enforced by the courts if any action taken by the corporation savors of the loss or waste of assets or is inimical to the rights of stockholders. It is perhaps the better plan to have all of the stockholders and all of the directors approve any plan of this character to which the corporation is a party. The transfer of stock into new hands

may lead to difficulty unless the action taken by the corporation has been in accord with the laws of the particular State.

WE SHOULD EXERCISE CAUTION

The law of business insurance trusts is not settled. To be sure we are dealing with only a contract, and the law pertaining to contracts is as old as our English common law. We may say, as a general rule, that where an agreement is equitable in its terms and conditions and does not violate any fundamental rule of law, it will be upheld by our courts. The business insurance trust is founded upon valuable consideration and may not be attacked on that ground. It is not opposed to rules of public policy, and its execution and continuation in the hands of capable managers is for the public good. The best decided cases hold that such a contract is not testamentary in character. It is a present, existing, executory contract, performance of which is to be deferred until a later time. The methods of determining the value of the stock are a mere matter of detail and subject to an agreement between the parties, which is equitable and fair. So long as we follow the fundamental rules of law and do not attempt to add supplemental trust agreements or other matters which may cause trouble, not only to the trustee but to the parties in interest, we may safely say that this type of agreement may be made binding upon all parties.

Discussion

ALBERT H. JEWELL (United States National Bank, Denver): I should like to ask Mr. Hall this ques-

tion: Should the trust terminate after the death of one of the stockholders or partners, or may it continue until after the death of one or all but one of the stockholders or partners?

MR. HALL: Of course, if there are only two stockholders, the trust would terminate upon the death of the first stockholder. If there are more than two stockholders, I think it is possible to have a continuation of the trust for the benefit of the other stockholders, although I do not think it is advisable to do so, for the reason that there will be additional stock not described in the original trust agreement to be made a part of the agreement, and for the further reason that insurance taken out in the first place is taken out to cover only the specific stock and not the additional stock added to it. So that I feel it is highly desirable that the trust should terminate upon the death of the first stockholder and the agreement be revamped.

NELSON M. MCKERNAN (Irving Trust Company, New York): My understanding is that in the case of the death of a party to such a trust, the stock is valued for sale as of the date of his death. Is there any possibility under an agreement such as this that there would be a responsibility upon the part of the estate or upon the part of the trustee to pay a greater income tax due to the fact that the value as of the date of death is greater than the original purchase price?

MR. HALL: That question involves the matter of whether or not the title passes to the stock when it is delivered to the trustee. There are perhaps some who would contend that the title would pass and that the difference between that value at the time received by the trustee and the value

as determined under the trust agreement may be taxable. But if we bear in mind that in arriving at the federal estate tax, the value as fixed by the agreement would be the proper value upon that stock, and that the government would undoubtedly assess federal estate tax against the stock as thus determined, there should be no income tax, the sale being made at the date of his death and there being no difference of time and no profit between the date of his death and the time the transaction was completed. So I believe that there will not be any federal income tax upon the profit, if any, representing the difference between the value of the stock at the time delivered to the trustee and the sale price. However, to be on the safe side, it perhaps would be beneficial for the trust companies to file a fiduciary return to the government, reporting the transaction.

FRANK BANCROFT (Colorado National Bank, Denver): I have been requested to ask Mr. Hall this question: Should insurance policies simply be made payable to the trustee or should they be made irrevocable, payable to the trustee, or should they be assigned to the trustee?

MR. HALL: The insurance policies are sometimes already written or issued by the companies, and there is a certain beneficiary. It is necessary to get the title to the policy out of that particular beneficiary and into the trustee. In order to do that, I should say it is advisable to have the title to the policy assigned to—or perhaps we should have a revocation of the appointment of the original beneficiary, the title of the policy returned to the party upon whom the life insurance is carried, and then he should make an assignment or an ir-

revocable power. I think perhaps an assignment to the trustee is best. The title then is taken out of the original beneficiary and vested in the trustee. This is important because if the point should be overlooked, the original beneficiary may claim the proceeds as against the assignee of the policy.

MR. BANCROFT: There is the further question: Is it desirable that the policy be made irrevocable in the name of the trustee?

MR. HALL: The beneficiary is first changed back to the estate and then an absolute assignment is executed.

HARRY FABLING (Pacific Mutual, Denver): Mr. Chairman, there is one question that has come up a number of times. It seems to me it is easy enough in most businesses to ascertain the inventory value of the business. The whole problem always seems to be this matter of good will. I should like to know if it is Mr. Hall's opinion that, if the stockholders or partners can agree on a set amount for the good will at regular intervals, or permanently, such plan is valid.

MR. HALL: Yes; that would come under the plan which I discussed that the trustee may rely upon any statement or any agreement of the parties as to value, because after all we are simply trying to determine the value of the stock. If you want to arrive at the value of the fixed assets and add to that, say, ten per cent for good will and fix that as the value of your stock—

MR. FABLING: Do you mean a lump sum?

MR. HALL: Yes, a lump sum. It is all right because it is simply an agreement between the parties upon which the trustee may act. Does that answer your question?

PAUL JOLLY (Travelers Insurance Company, Denver): Where there has been a declared valuation of stock, is that considered a contract of sale already made before the stockholder's death so that the stockholder could pay the premiums on his own policy with his wife as beneficiary and at his death the proceeds of the insurance policy would go to his wife on a monthly income basis for her life and the stock would go to the corporation? I wonder in what way that might be worked out; instead of the cash paid in a lump sum, could this money be paid to the wife for life on a monthly income basis, either by the

bank serving as trustee or directly by the insurance company itself?

MR. HALL: I think you have in mind the same principle I discussed under the name of the supplemental trust. You mean that the parties may enter into a contract as to the value of the stock; then the payment may be made by taking out insurance on the life of the stockholder, and instead of having the insurance proceeds paid to his estate, having a supplemental trust and payment made through the funds kept with the insurance company to be paid to a named beneficiary in instalments. I cannot recommend that plan.

Cooperation with Life Underwriters As They See It

By M. A. LINTON

VICE PRESIDENT OF THE PROVIDENT MUTUAL LIFE INSURANCE COMPANY OF
PHILADELPHIA, PHILADELPHIA, PENNSYLVANIA

Address before the Denver Departmental Conference

Mr. Linton, in discussing life insurance trusts from the life underwriter's point of view, treats the following topics:

1. The unique feature of insurance trust service
2. The importance of the human appeal
3. Policy settlement options
4. The life income policy
5. The life income option
6. The interest option
7. A complete program of family protection
8. Business insurance trusts
9. Negative aspects
10. The problem of security
11. A promising experiment
12. Making the plan generally available
13. Adequate publicity.

Mr. Linton believes that with the satisfactory solution of these problems will come a wave of enthusiasm for life insurance trust service that will surpass anything that has heretofore been experienced.

AS the life underwriter surveys the developments of recent years, he cannot but notice the surprising momentum acquired by the life insurance trust movement. In 1924 the amount of life insurance made payable during the year to fiduciary institutions totaled thirty-three millions. The figure for 1929, only five years later, reached the surprising total of one billion two hundred millions or thirty-six times the 1924 figure. The total amount of life insurance in this country now outstanding, payable under trust agreements, is estimated at two and one-half billions or very close to 3% of the total outstanding ordinary insurance. The

life insurance trust infant is rapidly acquiring the stature of maturity.

An important feature of the insurance trust movement is the large average size of the cases with which it concerns itself. The twelve hundred millions of life insurance placed under trust agreements during 1929 involved about fifteen thousand cases or an average of eighty thousand dollars per case. Clearly, we are dealing with a service that appeals to the man of affairs. As a corollary it is a service that appeals most to the life underwriter who has the ability to serve clients of substantial purchasing power.

The life underwriter sees the in-

surance trust as an instrument for rendering service that could not be rendered as satisfactorily in any other way. Therefore it is an instrument for creating an additional appeal for the sale of life insurance; a sound means of arousing interest that will result in larger sales. He finds in practice that there is a mutual advantage in cooperating with the trust officer. The trust officer, skilled in financial analysis, readily sees the need for adequate life insurance protection. His word as an impartial expert carries weight and in itself frequently brings about the placing of a substantial amount of life insurance. His experience in working out plans for family protection enables him to do better and in a shorter time what the life underwriter would have to attempt to do if he did not have the trust officer's cooperation.

The trust company benefits from the potential trust business that is placed upon its books. In a large percentage of cases the company makes the policyholder a client in one or more of its other departments. In a great many cases it becomes the executor and trustee under the policyholder's will; thus coordinating the administration of the estate and the life insurance proceeds.

THE UNIQUE FEATURE OF INSURANCE TRUST SERVICE

The unique feature of the life insurance trust that more than any other has brought the great development of recent years is the fact that the trust company is prepared to accept the proceeds of a policy under the provisions of an instrument giving the company the right to exercise discretionary power in the administration

of the fund. No one can foresee the future, and when a substantial sum is left for the protection of a wife and children, an inflexible method of distribution may fall far short of meeting the situation adequately. In fact, it may work a hardship which the policyholder would have done his best to prevent, had he realized what was likely to happen.

Educational contingencies need to be given especial consideration. When, as is the case in this country, more than one-half of those who enter college fail to graduate, an inflexible educational arrangement made years in advance may fall far short of the ideal. If a child is not adapted to profit from a college education or tries to enter and fails, or does get in and then fails to remain there, it is obviously best for the child that his financial needs be met as circumstances at the time may dictate.

Another type of educational contingency where discretionary power may prove valuable is that of the young man who takes a post-graduate course in some profession and then may need a reasonable amount of capital to help him out during the years in which he is becoming established. It is obviously impossible for any inflexible contract to meet these contingencies adequately.

Then there is always the possibility that ill health may overtake some member of the family and result in heavy doctor's bills or hospital expenses or in an expensive change of residence. The ability to make payments out of principal to meet these unforeseen contingencies is a most useful safeguard of the family's welfare. Nor is the problem adequately solved by using the interest settlement under the policy and giving to the bene-

fiary the right to make withdrawals of principal. It is obvious that prior to the happening of the contingency, withdrawal may have been made for the purpose of seeking a higher yield through investment in securities made attractive by clever salesmanship or by a prevailing wave of speculative enthusiasm. The unfortunate possibilities of this procedure are too well known to need comment.

Finally there is the far reaching contingency of a change in the purchasing power of the dollar such as occurred following the war. A given sum may be adequate now to cover certain types of expenses. No one can say what the situation will be twenty or thirty years hence. It is possible that the emergency use of principal under the discretionary power of a trust agreement may prevent suffering and render inestimable service to the widow and children. This unique feature of the life insurance trust cannot be duplicated by any other plan. It can be made to cover a wide range of contingencies in addition to the few outlined above.

Another feature of great value is the ability under the life insurance trust to combine the proceeds of life insurance policies issued by different companies. The unification of the administration of the funds arising from the different sources cannot be as satisfactorily accomplished in any other way.

THE IMPORTANCE OF THE HUMAN APPEAL

Trust companies are spending a great deal of money presenting to the public the merits of the life insurance trust. In their literature and advertising they frequently describe in a

rather general, impersonal way the ends that can be accomplished by providing for flexibility and the use of discretion in the handling of funds for family protection. I would suggest that the more they inject the human element into their appeal, the more effective it will be. That has been the experience of the successful life underwriter. He finds that his prospective clients respond in direct proportion to his ability to bring the human element concretely and vividly into his presentation. People are intensely interested in what has actually happened to other people.

The daily work of the trust officers of a large trust company is filled with all kinds of interesting human problems. If the company will select some of the typical ones and present them in appropriate detail, the interest value of their story will be greatly enhanced. Our intellects may respond to the words flexibility and discretion, but our hearts respond to the story of what has actually been done for the benefit of a man or a woman who faces the problems that we face. An effective booklet put out by a trust company for the solicitation of life insurance trusts is entitled *Ten Unusual Stories Taken from Life*. Their telling evokes a response that is more likely to lead to positive action than is a matter-of-fact impersonal description of life insurance trust service. By using this human interest method, a trust company will not only stimulate the interest of policyholders; it will also arouse the life underwriter to the possibility of getting action by presenting trust service.

POLICY SETTLEMENT OPTIONS

The use of the life insurance trust

grew naturally from the development of the settlement income options contained in life insurance policies; and the great emphasis that is being placed upon trust service has made some life underwriters feel that the options are not getting the attention they deserve. It should never be forgotten that the life annuity principle embodied in the life insurance company's service is unique in that it uses both principal and interest to provide a guaranteed income which the beneficiary cannot outlive.

Sometimes the energetic representative of a trust company finds a policyholder who has outstanding life insurance payable under an income plan. In his enthusiasm for the trust service, he may persuade the policyholder to change the arrangement worked out by the agent, thereby creating a feeling of antagonism on the part of the latter. Such situations are obviously to be avoided. Sometimes the difficulty arises because the trust company representative does not understand the results that can be accomplished under the life insurance policy.

THE LIFE INCOME POLICY

For example, suppose a policyholder, aged thirty-five, with a wife of the same age, should take out a life income policy providing in the event of his death for the payment to his wife of a monthly income of \$100 for as long as she shall live, with a guarantee that in any event payments will be made for at least twenty years. In some instances the total period of the income will be thirty, forty, or even fifty years following the death of the policyholder.

On the present dividend basis such

a contract can be obtained for a deposit averaging \$351 during the first ten years. The income to the widow for the first twenty years after the policy becomes a claim will be increased by so-called "excess interest." On the basis of present performance this provides a total monthly income of \$110.90 for the twenty year period, followed by the flat \$100 a month payable during the remaining lifetime of the beneficiary.

Now suppose the policyholder, at the age of thirty-five, should purchase an ordinary life lump sum contract for the same average deposit of \$351 a year for ten years. The amount of the lump sum policy will be \$19,470. If this sum is invested by the trust company to yield 5% net after payment of taxes and expenses, and payments of \$110.90 a month are made for twenty years and \$100 a month thereafter, the entire fund will be exhausted as to principal and interest in $26\frac{1}{4}$ years, or only $6\frac{1}{4}$ years beyond the guaranteed period of the life insurance policy. It is obvious that the life insurance policy with its guarantee may be the most satisfactory policy for the protection of the beneficiary who may live for many more than $26\frac{1}{4}$ years after the death of her husband.

THE LIFE INCOME OPTION

The life income option cannot be so readily compared with the trust plan because the amount of the annuity provided by the option depends upon the attained age of the beneficiary. The greater the age the larger the income. Averaging the figures for six companies and making due allowance for the excess interest during the period of twenty years,

we find that when the beneficiary is above the age of thirty-five when the policy becomes a claim, the policy proceeds invested at 5% net will duplicate the option payments until the beneficiary attains the age of approximately eighty years, and then will be entirely exhausted as to both principal and interest. The option, of course, by using the life annuity principle, provides that the payments will be made as long as the beneficiary may live beyond the minimum guaranteed period of twenty years.

These figures show two things: First, that the life income policy affords exceedingly satisfactory protection for the young man with a family; second, that the life income option should be chosen in place of the life insurance trust service primarily because of considerations of security or because the amount of the policy is relatively small.

THE INTEREST OPTION

When the amount of insurance is substantial, the interest option of the life insurance policy is deservedly one of the most popular. In many instances it meets the situation admirably, especially if there is a separate estate to provide flexibility. The proceeds of the policy are retained by the life insurance company and mingled with its entire assets. All of the resources of the company are pledged to guarantee both the safety of the principal and the payment of a minimum rate of interest, either 3% or 3½%. In addition, the company pays excess interest depending first upon the net rate earned upon the company's assets, and second upon the expenses of maintaining the machinery for handling the option settle-

ments. This year the average rate of interest thus being paid by a representative group of fifty-two companies is 4.87%.

The interest may be paid in equivalent monthly instalments beginning immediately upon the approval of the claim. The beneficiary may be given the right to draw upon the principal. For example, if the fund were \$25,000, she could be given the right to withdraw up to a total of \$10,000 but not more than \$2,000 in any one year. The combinations that can be made are many. When there are minor children, it may be desirable to hold a portion of the fund at interest for a given period, and then at the end of the period have it applied to pay a stated income either for life or for a limited period under one of the income options using the annuity principle. Although this type of settlement involves considerable inelasticity, it may not work a hardship if there is an additional fund either from other life insurance or from the general estate which can be administered by a trust company empowered to exercise a wide latitude of discretion.

A COMPLETE PROGRAM

The complete program of family protection which appeals to many life underwriters is this: first, lump sum insurance of sufficient amount to provide for immediate cash needs—expenses, taxes, an outstanding mortgage, and other cash obligations; second, a reasonable amount of insurance payable under a settlement plan provided by the policy, thus affording a backlog of income that is secure beyond a doubt; third, the balance of the insurance to be handled by a trust company under a trust agreement giv-

ing the trustee adequate discretionary powers; fourth, the general estate to be similarly administered by the trust company acting as executor and trustee under the will. In addition to the foregoing, there is frequently need for business insurance when the policyholder is engaged in a business enterprise either as sole proprietor, as partner, or as stockholder in a close corporation.

Speaking of business insurance brings to mind the invaluable service that the corporate trustee is able to render in handling the details of business life insurance trusts. The taking of business life insurance is in many ways the only practicable manner in which the interest of the owners of the business and the families of the owners can be adequately safeguarded. The subject is acquiring a voluminous bibliography, and this is not the place to go into details. Every trust officer and every life underwriter who aspires to attain prominence in his profession should become familiar with the things that can be accomplished by the business insurance trust and with the ways of putting it into effective operation.

In this field also there is opportunity to inject the human interest appeal by telling the story of actual cases having a high human interest value. The same trust company which put out "Ten Unusual Stories Taken From Life" has also issued another booklet, admirably executed, entitled "Eight True Business Stories."* The booklets contain an interesting description of actual cases

where business problems have been solved by the use of life insurance and in conjunction with the corporate trustee. Here is one. It is a simple case, told in a way to arouse the interest of the layman. The names, of course, have been changed in telling the story.

HE WANTED HIS SON TO SUCCEED HIM

PROBLEM

William Ames and Edward Brown were in business together. Mr. Ames owned 49% and Mr. Brown 51% of their corporation. Mr. Ames was married and had a son in the business. Mr. Brown had a wife but no children. Mr. Ames wished to acquire Mr. Brown's stock should Mr. Brown die. Mr. Brown was willing because he wanted his wife relieved of the uncertainties of stock ownership. Mr. Ames wished that at his death his son should succeed to his stock interests.

SOLUTION

We suggested that the two stockholders, Ames and Brown, enter a trust agreement with the trust company as trustee. This agreement provided that:

1. If Mr. Brown died first, Mr. Ames would be given the first opportunity to purchase his stock at its then value. The amount paid by Mr. Ames for the stock would be held in trust for the benefit of Mr. Brown's widow.

Mr. Ames would take out insurance on the life of Mr. Brown equal in amount to the present estimated value of the stock. This assured Mr. Ames of a considerable amount of ready cash for the purchase of the stock at Mr. Brown's death.

* These booklets may be had at cost - 85c per copy - by addressing Provident Trust Company, 17th and Chestnut Streets, Philadelphia, Pennsylvania, which has on hand a limited supply.

2. If Mr. Ames died first, his stock would be held in trust, by the trust company, with the income from the stock payable to Mrs. Ames until her death.

The right to vote the stock, however, was given to the son and on his mother's death he would receive the stock outright.

Under these plans both widows were provided for. Mr. Ames was sure of being able to buy Mr. Brown's share, if Brown died first. Mr. Ames was also sure that his son would ultimately succeed to his interest in the business.

The surface of business life insurance has barely been scratched. It is worthy of the close study of any life underwriters who have not given it adequate consideration.

PLAIN TALK

When I was asked to prepare this paper I was requested to "speak out in meeting" and not confine myself to the saying of nice things as in a mutual admiration society. With that introduction, here goes.

In the practical handling of life insurance trusts the personal relationship between the life underwriter and the trust officer counts for a great deal. When the trust officer enters sympathetically into the problems of the underwriter and his client and is able to solve them satisfactorily, repeat business will surely follow. Once in a while we find trust officers who are but imperfectly equipped to render adequate insurance trust service. And there are others who adopt a "high hat" attitude that stands in the way of repeat business. People get all kinds of impracticable notions about the things they would like to do with

their money. Tactfully leading them to choose what is practicable is an important part of the successful trust officer's job. It does not take long for the life underwriters of a community to discover where they can go for the most helpful cooperation.

If I were looking at the picture from the trust officer's point of view, I would have something to say to some of the underwriters who desire to share the benefits of life insurance trust service without making an adequate contribution in return. I would advise some life underwriters to master their subject. Others I would advise to cultivate an attitude which would lead to a happier spirit of cooperation. It would mean money in their pockets and enable them to conduct their canvassing upon a higher plane when dealing with men of affairs.

Fortunately these negative aspects are relatively unimportant when compared with the vast amount of helpful cooperation that is building a noble edifice for the service of policyholders, underwriters, life insurance companies, and trust companies.

THE PROBLEM OF SECURITY

One other question which should be discussed candidly is that of security. If there is any one thing that causes the underwriter to hesitate to recommend wholeheartedly the life insurance trust arrangement, it is the fear that perhaps the funds may suffer loss in the hands of the trust company. The impregnable security of a life insurance company is a basic conception in the minds of those who represent the company in the field. They are taught that if a man entrusts his money to a well established life

insurance company, he has put it in one of the safest possible places: first, because the company is conservatively managed; and second, because it guarantees a certain minimum performance and then backs up its guarantee with its entire resources. Thus he enjoys the protection afforded by the mingling of his money with the general assets of the company. He receives the benefit of the law of averages applied to investments.

In the case of the trust company there is no guarantee of the integrity of the principal or of any rate of interest. The funds comprising the individual trust are segregated and separately invested. It will of course be taken for granted that the trust company will give as careful supervision to the investments in the fund as does the life insurance in the handling of its funds. But the fact remains that the trust fund is relatively small, so that the possibility of loss may be appreciable. Naturally there is a corresponding possibility of gain. But we are not looking for appreciation if it must be accompanied by a corresponding risk of loss.

In the literature dealing with life insurance trusts, very little is said about the security of the principal of the funds administered by the trust company. Of course the care of the investments by experienced men, officers and directors, is stressed. But even the wisest men make mistakes. Investments do go bad from unforeseen and unpreventable causes. And when the investments are part of a relatively small fund, the loss may work a hardship. Reviewing the financial history of the past generation, we find many securities which have gone wrong in spite of the fact that they were once considered trust

investments of the first grade. Although the stirring financial events of last fall had to do with common stocks, the thoughts of many men have turned afresh to the question of security and to the law of averages as applied to investments.

While on the subject of security I would mention in passing, an investigation of trust funds made several years ago. It was then found that only to an infinitesimal extent had there been losses of such a nature that they could legally be charged against the trustee. Obviously this does not touch upon the point we are considering. We assume integrity and the exercise of due care on the part of the trust company. What we are interested in, is a system that will reduce to an absolute minimum the individual effect of such investment losses as may be incurred through nobody's negligence or dishonesty.

ONE ATTEMPT TO SOLVE THE PROBLEM

In 1925 a middle western trust company made an excellent start toward the solution of this problem by setting aside a special reserve fund of \$2,000,000 to be used to indemnify against "loss of principal or interest on securities bearing interest and having a definite maturity, purchased with trust funds by the company as sole trustee in the exercise of its own discretion, which beneficiaries of trusts may sustain at the time of the maturity of such principal or interest or at the time of sale of such securities by the company." The declaration of trust recites many important details, but this is the essence of the plan. Three years later an executive officer of the company in a published statement

summarized the experience under the plan and stated that it had been most satisfactory from every point of view. In particular it had been instrumental in attracting business because of the additional security thrown around the handling of the trust funds.

Although the plan is an excellent one so far as it goes, there is always the question of the ability of any limited fund to replace losses that may conceivably be incurred in a large volume of trust investments. When all is said and done, it remains true that the safest plan is that of mingling the funds and thereby having the benefit of the law of averages. The funds can then grow to any size without lowering the factor of safety.

A MOST PROMISING EXPERIMENT

A large trust company in New York has recently developed a plan for giving to the trust funds in its possession the benefits of this averaging principle. A corporation has been created for the purpose of investing the funds realized from the sale of its securities to the trust company, which, as trustee, purchases them for trusts where the instrument creating the trust gives the company the power to do so. The corporation securities are sold in units, each consisting of one \$100 income bond bearing 6% interest payable out of current income, and of one share of capital stock, the initial value of which is \$50. Following the inauguration of the fund on April 15, 1930, subsequent units are being sold at the price equivalent to \$100 for the bond, plus the liquidating value of one share of stock on the day a new unit is issued. This is also the value for which the units will be repurchased or redeemed when

trust funds invested in the corporation are being withdrawn.

The funds of the corporation, to quote the official booklet describing the plan, will be partly invested in "fixed income-bearing securities such as bonds, mortgages, and preferred stocks. A proper proportion from time to time will be invested in common stocks, depending upon prevailing financial and economic conditions. To do this with maximum safety it is proposed that the fund will purchase a great number of stocks which represent the leading corporations in industries where growth is most current.

"The fixed income-bearing securities such as bonds and preferred stocks offer maximum stability of principal and furnish a bulwark against unforeseen crises and cyclical periods of depression, while the common stocks permit each participating trust to share in the industrial growth of the country. Because of the wide diversification and flexibility made possible by a large co-mingled fund in corporate form, it is believed that over a period of time the increase in many items of investment will more than offset possible losses in others; thus making the net result of the entire fund the supreme test rather than the success or failure of any particular item. This is in accordance with modern practice of sound investment; that is, obtaining safety of principal, reasonable income, and a chance for appreciation through diversification and rotation."

In this plan we have a development of great significance. It is, I believe, the most promising step taken in the direction of affording trust funds the protection involved in being part of a large co-mingled fund. Opinions will naturally differ about the wisdom of investing a part of the fund in com-

mon stocks. That point may have to be met, perhaps by establishing another fund on a different basis. For the present the type of investment is not so important as is the fact that a plan has been formulated which enables individual trust funds to have the benefit of the averaging process.

MAKING THE PLAN GENERALLY AVAILABLE

The next step in the program is going to be the working out of a plan whereby trustees who are not in a position to establish their own commingled funds, can invest in the securities of such a fund administered by an institution that commands the confidence of the financial world.

There are hundreds of fiduciary institutions throughout the country which could go out and get life insurance trust business if only this problem of security could be solved to the satisfaction of the life underwriter and his client. The local institution can be given the necessary discretionary power in the administration of the fund, a function which even a small institution can satisfactorily perform. The security of the fund would then be assured by investment in the securities of one or more designated funds of the kind we have been discussing. Obviously there is a great deal of spade work to be done before the plan is perfected. That it is a field worthy of intensive cultivation I am thoroughly convinced.

The principle of the co-mingled fund which we have been discussing is of course the basis of the investment trust which has recently had a spectacular growth in this country. Essentially the principle is not new. Practically it is, because it is being

applied to the definite purpose of providing an investment channel for trust funds. The fact that it is devised for the investment of such funds means that the enterprise must be conducted on the very highest plane. It must appeal to the conservative trustee as well as to the man who in the first place accumulates the estate and who desires the greatest possible security in the carrying out of the plans he has formulated for his family.

ADEQUATE PUBLICITY

And now a thought about one feature of the administration of the commingled fund. If it is to command confidence so that a man will entrust to its care funds which are to be held for perhaps a generation or two, he is going to demand a check upon the management. One check is likely to take the form of giving to the public a list of the investments in the fund. This is what the life insurance companies have been doing for a long time. They prepare each year a complete list of the securities and their values which is available to any one desiring a copy.

This principle is exceedingly worth while in establishing confidence. The knowledge that investments will be made public acts as a direct check upon any tendency of the management to take unwise chances. The life underwriters have been used to having the benefit of this publicity principle, and as a class they are likely to want it in connection with the funds they are asked to recommend for the investment of life insurance policy proceeds.

In the absence of definite knowledge, it is one of the inevitable human tendencies to allow the imagination to

fill in the gaps. Accurate information is the most effective safeguard against unfavorable rumors. Two thousand years ago Cicero wrote in a letter to his son Marcus, "All things should be laid bare so that the buyer may not be in any way ignorant of anything the seller knows."

Publicity for the investments of funds of the kind we have been discussing will go a long way toward bringing the voluntary, enthusiastic cooperation of life underwriters throughout the length and breadth of the land.

In urging this course I am not unmindful of the pros and cons of the principle of publicity for funds operating on the investment trust plan. We have been hearing a great deal of discussion about it recently in New York State. As with most other questions, there are two sides and it is a problem of choosing that course which on the whole will work out best for all concerned.

RULES OF THE NEW YORK STOCK EXCHANGE

The New York Stock Exchange has had the problem under consideration and its present rules for the listing of the securities of an investment trust include a stipulation, the gist of which is as follows: The trust shall publish with each annual report a complete list of all of the holdings of the company showing names and quantities with values on the basis of the market price of all securities listed on recognized stock exchanges and upon fair appraisal of other securities, with the proviso that securities held for not more than one year may be listed as "miscellaneous securities" up to an amount not to exceed 10% of

the company's aggregate capital and surplus, or 10% of the cost of securities held, whichever may be less.

Here we have a plan which provides for reasonable publicity combined with an exception which enables the trust to withhold information about some of its more important moves until publicity is likely to have but little effect. This stock exchange requirement may not be the best that can be devised for a co-mingled fund such as we have been discussing. But some plan of reasonable publicity can undoubtedly be worked out which will enable the public and the prospective investor of trust funds to judge of the character of the funds they are solicited to patronize.

Life insurance trusts are going to continue to grow in volume whether or not the security problem is completely solved. But their growth will be greatly accelerated if it is solved. If we can have the local trust company administering with adequate discretionary powers the distribution of the income and the principal, and at the same time have the investments co-mingled in large funds that are corporately managed with the highest ideals of trusteeship by men of great ability and experience—then I predict that there will be a wave of enthusiasm for life insurance trust service that will surpass anything that has heretofore been experienced.

Discussion

ISADORE SAMUELS (New England Mutual Life Insurance Company, Denver): Mr. Linton, have you any concrete evidence that the question of security is in the minds of life underwriters?

MR. LINTON: The president of

one of the smaller New York companies made a speech in Newark not long ago, in which he said that it was a matter in the minds of a great many life underwriters. The officer of one of the large New York insurance companies made a speech last month before the New York State Life Underwriters, in which he pointed out a similar sort of thing.

I have here a copy of an article from the National Underwriter of February 7, 1930, in which they walk right into this subject with both feet and say that lots of underwriters are saying in the open what they have been saying under their breath heretofore. I will not read this, but I think it is in the minds of a great many people as a result of financial disturbances which we are all familiar with, perhaps participants in, I don't know.

MR. BARTON: (Colorado Title & Trust Company, Colorado Springs): What is the minimum amount of insurance to which it is advisable to apply the insurance trust service?

MR. LINTON: I think that depends on the conditions. I outlined what I thought was the ideal plan, a certain amount for lump sum, a certain amount for backlog, and a certain amount for life insurance trust service. I think the backlog for men should be the \$150 minimum. What the lump sum should be depends on obligations. I doubt whether the insurance service is very useful unless the amount left over for that is about \$25,000 as a minimum. Many people will argue on that question. Perhaps it ought to be \$20,000. If a man is a potential buyer, that is another thing. A young man who has bright prospects in his business today, if he starts out and makes \$10,000

or \$15,000 payable to a trustee, in all probability in the next twenty years will add much more. That is a very legitimate amount to start with.

What we are interested in is the potential amount that is likely to be in the trust. Since these trusts were \$80,000 in amount on the average last year, you see we are dealing with a rather large figure. The trust companies cannot afford to spend very much time in exercising discretion over very small funds. That is pretty clear, too. You simply cannot do it. The compensation is too small. I don't know whether they would argue about it, but I should suppose \$25,000 came pretty close to being the minimum if you had that as a potential sum to look at in the future. Perhaps in the big cities, I mean cities like New York, for example, the biggest cities in the country, \$50,000 might be the figure. I think you always want to analyze it in terms of the whole story and also the amount of the estate which they have in addition.

MR. WINNEY (Connecticut Mutual, Denver): I have not heard anything said about whether or not there might be an advantage of co-trustee in some life insurance estates.

In connection with that question, I should like to know whether or not it is advisable to stipulate in a trust agreement that a trust company should not deal with itself in the matter of purchase and sale of securities in which it is interested. That is a question that is in the back of the minds of some men and there may be a basis for it.

MR. LINTON: The question of the co-trustee I am glad you called to our attention. I have this in my

own agreement. Wherever it comes to the exercising of discretion, the trust company agrees to consult a friend of mine in making up its mind as to what shall be done. There is a lady here who does not approve of that. I should like to know why she does not. It seems to me there is an advantage in having some one who is personally interested in the family in on the discussion of whether or not it is wise to do certain things with the principal.

That co-trustee gets no fee and is not responsible for the investment policy, but it is only helping the trust company arrive at as sound a decision as possible with regard to matters affecting my wife and children.

As to the question of whether the company shall deal with itself or not, very frequently, of course, the trust company owns the securities or the stock of a subsidiary company which is an investment company. Is that itself? Do you mean the subsidiary company is the trust company itself?

MR. WINNEY: Many banks have trust departments; it is conceivable that there might be an issue of certain securities that had been allotted to a trust company's bond department that might be unloaded upon these individual trusts.

MR. LINTON: Coming from Philadelphia, I think I agree with you, because it is pretty clear in Philadelphia. I know the larger trust companies in Philadelphia are not dealing in securities. They are trustees and not investment bankers. Therefore, the Philadelphia idea is that the two things should not be mixed together. I think it is sound that they should not do it. I doubt whether I should do it. If I were in a community where that was going

on, I am very much inclined to think I would put some arrangement in my trust agreement which would prevent that. I may be walking on very thin ice here. Personally, I do not like that idea and I would not have it, if I could help it.

HOWARD A. FOSTER (Provident Trust Company, Philadelphia): I might answer that question by saying that we do not invest in such securities just for our own protection, because we know that the Orphans Court would surcharge us if any loss were suffered by an estate in which we purchased securities from our own banking department.

THE CHAIRMAN: I assume, sir, that is the universal rule, in the absence of stipulation to the contrary, on equity court on the general trusts, and the Orphans Court on probate trusts would undoubtedly surcharge the trustee in event of loss.

MR. WINNELL (New York Life Insurance Company, Denver): One of the gentlemen who left wanted to know why insurance proceeds should not be paid to the executor or administrator.

MR. LINTON: In other words, it is perfectly possible to get the insurance money into the hands of the trust company by way of the will. Why not do it that way? I do not believe that anybody here can fail to answer that question himself. We all know that when it goes through the will there is the probate and delay involved, the expenses of all the procedure, the possibility of a will contest and also certain elements of taxation, whereas if it is payable to the trustees for the definite benefit of the insured's family, there is no delay. In a great many states there is no state inheritance tax in such

cases and there is an exemption of \$40,000 of life insurance in the federal estate tax. The money goes direct to the trust company and begins to work immediately, whereas it takes a year to settle an estate and you may have somebody upset it.

I think we all realize as life underwriters that where we find a policy made payable to the estate, it certainly is a red flag which means stop, look, and listen.

In most instances, it is made payable to an individual or to a corporate trustee or in some manner such as that. Also the contingent beneficiary (I do not need to go into that) is very important, because if the main beneficiary dies without a contingent beneficiary, frequently all our policies revert back to the assured and that means his estate in event of his death without some change. I am sure you are all familiar with that; at least ninety-five per cent of you are.

MR. BARTON (Colorado Title & Trust Company, Colorado Springs): Would lump sum insurance be advisable for a stockholder under business insurance?

MR. LINTON: I wish Mr. Hall would answer that.

RAYMOND W. HALL (The First National Bank of Kansas City, Kansas City, Missouri): I don't know that I understand the question. Of course it is all lump sum if it is payable to a trustee because the trustee collects the insurance and the entire proceeds from the policy.

MR. BARTON: For example, suppose a stockholder says, "I will take out \$5000 insurance to be paid to my estate or beneficiary, regardless of the estimated or appraised value of the stock."

MR. HALL: I don't see any bene-

fit in taking out life insurance for that purpose. He might as well take it out on his own life and have it payable to his beneficiary or whoever he wants to receive the proceeds, and he would still have his stock besides. Unless the money is going to be used in some way to satisfy or redeem the stock, there is no reason for taking it out from the standpoint of business insurance. I should think it would be all right for him to add it to his personal life insurance.

EDWARD P. JENNINGS (Exchange Trust Company, Tulsa): We have a case before us now in which the proceeds of life insurance are payable to the trustee, the same company also acting as executor. In filing the federal estate tax return, we naturally deducted our exemption for the \$40,000 odd paid into the hands of the trustee from this life insurance under the life insurance trust. I have a letter before the Commissioner of Internal Revenue at the present time protesting the ruling by the federal agent that since the trust instrument gave the trustee the right to loan money or even to pay federal estate taxes or any other taxes that might be due upon the estate, that was, as he in his own words said, a subterfuge to defeat the federal estate tax.

THE CHAIRMAN: If the instrument provided only for the loaning of money to the executor, or the purchase of assets from the executor, we would be safe, and there is hardly any question but that the commissioner would rule with us. I know of no case in which there has been any serious doubt raised. But if the instrument provided we might pay the taxes or pay the debts, we would be in dangerous water. I think there has been no decision upon that.

Fee Schedules for Personal Trust Service

By J. W. GARTHWAITE

VICE PRESIDENT AND TRUST OFFICER OF THE OAKLAND BANK,
OAKLAND, CALIFORNIA

Address before the Denver Departmental Conference

Mr. Garthwaite summarizes the present situation as follows:

1. Where fees are the subject of statute, a condition bordering on chaos exists; there is no uniformly accepted theory upon which charges should be based; even in cases where the same basis is used, the rates vary beyond reason; in many cases, the statutes are not capable of simple interpretation.

2. Many states have no associations of trust men for the discussion of fees and other problems.

3. Among the trust companies there is no complete uniformity of practice as to the duties involved in various types of service.

4. Where a considerable degree of uniformity of practice does exist, charges vary widely, and the rates having most general acceptance are the same as have been used without change for a great many years, regardless of changing conditions.

5. While there are many carefully prepared fee schedules in the country, in very few instances are these based upon a study of the cost of doing business.

6. In most instances where schedules have been set up, it seems an accepted rule that reductions will be made to clients of other departments.

Mr. Garthwaite goes on to discuss the necessity for reasonable compensation, and the possible improvements in this situation in the way of standardization.

MORE than one hundred years ago the first corporations with trust powers were chartered in this country. That the importance of these institutions was promptly recognized is evidenced by the rapidity with which new companies with similar powers came into being, not only in Massachusetts and New York where the first charters were granted, but in many other states as well.

Little is found in the early records to indicate any careful consideration of the fee question, probably because

of the fact that with the rapid development of these companies an early attempt was made by politicians and press to put them on the defensive. Thus in 1835 an editorial appeared, calling attention to the fact that a trust company had recently been established in Cincinnati, possessing many novel and exclusive privileges never before conferred upon a "monied institution," and the editor predicted "much evil from this bank." Faced with the necessity of meeting this attitude and convinced that the

public would accept and make use of the facilities offered by their organizations, the trust companies gave many years of study to the building up of their own efficiency and to educating the public as to the value of trust service before any concentrated attention was given to the question of fees.

At the opening of the present century the trust companies of the country had grown to such an extent that the Trust Company Division of the American Bankers Association found that it had enough men of experience in its organization to make possible the appointment of a fee committee without in any way reducing the work being done in extending, systematizing, and improving trust service. Accordingly, in 1902 the appointment of such a committee was approved, and although many similar committees were later appointed, this appears to have been the first to take up the study of this important subject seriously and systematically.

NO UNIFORM SCHEDULE

As the fee situation in the country now stands, there are two distinct sets of charges to be considered. First are the commissions allowed to executors and administrators, a subject which has had the attention of the various law-making bodies of the country for many years. An investigation made by the Trust Company Division in 1925, intended to determine, among other things, the length of time laws on this subject had been in effect in the various states, brought out many such answers as "over a hundred years," "more than seventy-five years," "since 1830," and so on. Nevertheless, it is found not only that

no generally accepted schedule has been arrived at in these years, but that there is not even a generally accepted theory upon which the charges are based. Thus, in six states the statutes are silent; in seven the courts are required to fix reasonable compensation; while in the remaining thirty-six (and also in the District of Columbia) there are statutes covering the subject more or less adequately and completely.

It may appear from these figures that a considerable majority of our legislatures have set up workable and satisfactory schedules; but this is far from the truth. As has been shown, thirty-six jurisdictions have taken legislative action looking beyond the mere assertion that the court shall allow proper compensation, but of these some allow fees only on the amount of money received and paid out; others use as a basis a percentage of the value of personal property in the estate; certain others accept the theory that the executor or administrator is entitled to compensation on the entire value of estate accounted for, while in one instance the legislature, having read its Bible and believing the laborer to be worthy of his hire, allows the executor four dollars a day while engaged on estate business. Fortunately the final decision as to the actual amount to be paid is left to the court, and it is understood that by custom a fee is allowed based on a percentage of the gross estate.

NO UNIFORM LEGISLATION

Having decided which of the various theories to adopt, it would seem that uniform legislation might be enacted by the states following the same

theory, but in fact it is found that fees on the amount of money received and paid out vary from $2\frac{1}{2}\%$ to 5% ; while in those cases where charges are made on a percentage of the gross estate or the personal property, the variation is so great that the fee for probating a \$10,000 estate, if the statutes are strictly followed, may range from \$100 to \$700; that for a \$50,000 estate, from \$350 to \$3,500; that for a \$100,000 estate, from \$600 to \$7,000; that for a \$500,000 estate, from \$2,600 to \$35,000; and that for a \$1,000,000 estate, from \$5,100 to \$70,000. In making this comparison it has been arbitrarily assumed that one-half of the estate will be in personal property so that the two types of schedule may be fitted together.

It might appear that the compensation allowed to guardians and testamentary trustees should have been considered with the schedules applying to executors and administrators; the fact is, however, that these fees have been so generally left to the discretion of the court or ignored entirely by the legislators that they are more properly to be considered in connection with the private trust schedules which are now to be discussed.

CHARGES SET UP BY TRUST COMPANIES BY AGREEMENT

The second of the two sets of charges referred to earlier is that set up by the trust companies by agreement among themselves; or by agreement with their clients or with the courts in those cases where statutes are silent or allow reasonable fees.

In the belief that the most fruitful source of information regarding these schedules would be the various cor-

porate fiduciary associations, a check of such organizations was made. Here again numbers do not tell the whole story. It was found that there were, early in the present year, fifty-seven such associations in the United States. But many states have not limited themselves to one association, and some have as many as four. Therefore, the rather imposing total leaves seventeen states without proper facilities for discussing the many problems which constantly arise in the trust business.

A letter and a questionnaire were sent to one officer of each of the associations outside of California listed in the American Bankers Association Directory of Corporate Fiduciary Associations, and also to at least one trust man in each state where there was no such organization. These letters brought to hand twenty-three formal schedules of charges, and a great deal of information as to fees in those states where no schedules have been prepared. As might be expected, these rates are much more nearly uniform than those set by law, but even here there are some interesting variations.

DIFFERENCES IN SERVICE

The schedules submitted bear dates extending fairly evenly over the past ten years, the earliest being that of the Trust Company Division of the American Bankers Association, which was approved in 1920. In form they run from four page leaflets giving merely an outline of suggested fees to pamphlets prepared in elaborate detail and setting forth fully the rates to be charged for almost every conceivable trust service. To arrive at a satisfactory comparison of the fees

charged, it is necessary first to compare the services themselves as they are understood and handled in different parts of the country. For example, it will be found that in one section a safekeeping account is taken to be an account in which the trust company holds the securities of the depositor, collects income, cuts coupons, receives dividends, and credits all income or principal collected to the account of the depositor, or mails checks, as directed, keeping records and making frequent statements to the depositor, supplying such information as may be necessary for the preparation of income tax returns, and in some instances may even include periodic review of securities. In another, an account with a similar name means merely the cutting of coupons and turning them over to the banking department for credit, leaving to the banking department the keeping of records and notifying of the depositor. Certainly the fees charged for these two services cannot be compared.

There is, however, one form of service which seems to be fairly uniform in all sections of the country. Nearly every schedule of charges contains a set of fees for holding cash and securities, together with the real and personal estate of a living person, under a voluntary trust to manage, convert, invest, and reinvest the principal, and to collect and distribute the income. Since the services to be rendered in such an account appear to be uniform and since the fees set up under this heading are usually substantially the same as those used for testamentary trusts and guardianships, it has been taken for the basis of the following comparison.

This schedule must be taken up

under five distinct subdivisions, each of which will be considered separately. First is the acceptance fee, which, regardless of the name by which it is called or the manner in which it is assessed, is intended to compensate the trust company for the time used in preliminary discussion, the labor of listing the assets and setting up the account on the books, the cost of security analysis and examination of real estate, checking of insurance policies, and all of the other work necessary to be done immediately upon the opening of a trust in which the trustee accepts the responsibility of management. The principle of the acceptance fee is quite generally accepted among trust men, but as there seems to be an aversion on the part of the public to what seems to be paying the bank for accepting business, other methods of arriving at the same result have been tried in some instances; but in most cases the charge has been eliminated. In those few cases where this item appears in the schedules, it varies from one-fortieth of one percent to two and one-half per cent and is called variously an acceptance fee, a setting up fee, an opening fee, or a fee on corpus to be taken one-half upon opening and one-half upon closing; it seems that this latter method produces much the higher fee.

THE ANNUAL CHARGE

Second, and most important, is the annual charge. Thirty-four schedules and letters were examined as to this subdivision, disclosing a marked difference of opinion as to the basis upon which the charge should be fixed, nineteen using a percentage of gross income collected, and fifteen basing

their charges on the fair value of the corpus.

Of those using the income basis, sixteen are agreed on 5% as the rate to be charged, one sets 6%, and the other two use sliding scales varying from 2% to 5% depending on the amount of income handled. It may be added that 5%, the most usual rate, is the same as that fixed in the by-laws of a trust company in New York as early as 1871. Among those using the corpus as the basis, there is considerably less uniformity, although in eight cases we find one-half of one per cent, the same rate as that fixed in 1833 by a Massachusetts company. Not all of the eight, however, use one-half of one per cent as the only rate, as in several cases sliding scales are used depending on the size of the trust and the nature of the property, higher rates being charged as a rule on real than on personal property. As a whole, the rates on corpus range from three-tenths of one per cent to three-fourths of one per cent.

In order to bring these schedules into line for comparison, it is again necessary to make certain arbitrary assumptions. First, for those cases where the rate charged on personal property is different from that on real property, it will be assumed, as before, that the trust will be one-half real and one-half personal; and, second, it will be assumed that the average gross return will be five per cent. If this starting point be accepted, it will be found that the annual fee for handling a \$10,000 trust will vary from \$25 to \$75; for a \$50,000 trust it will vary from \$112.50 to \$375; for a \$100,000 trust, it will vary from \$175 to \$750; for a \$500,000 trust, it will vary from \$645 to \$3,750; while for a \$1,-

000,000 trust, the variation will be from \$1,020 to \$7,500.

SPECIAL CHARGES

Next to be considered are those special fees which appear in some of the schedules to be charged for various services which the trustee may be called upon to perform from time to time in the management of the trust. In some cases, for example, there is a charge for the re-investment of principal running from one-half of one per cent to one per cent; in some instances, one-tenth of one per cent is charged for the exchange of securities; in others, a special charge is noted for the execution of deeds, leases, and other similar documents; occasionally, there is a charge ranging up to five per cent of the moneys expended for supervising repairs on buildings; while in other cases, one-half of one per cent of gross income reported is asked for the preparation of income tax returns. This group is of little importance, but it has a place in so many of the schedules that attention is called to it as an indication of the efforts which are being made to fix a charge for each service rendered and to meet changing conditions.

THE REVOCATION FEE

The fourth subdivision, recognized in only a few schedules, is the revocation fee. This charge is intended to compensate the trustee in cases where the trust is terminated before it has run its normal course, and appears to be entirely justifiable, particularly where there is no acceptance fee and the cost of setting up the trust is expected to be absorbed over a term of years in the annual fee. As has

been said, this charge appears in only a few schedules, but there are one or two interesting examples in which a charge of one per cent is made for revocation within one year with a reduction of one-tenth of one per cent each year until, after ten years, the charge is eliminated or absorbed in the regular closing fee, which is the last of the five subdivisions mentioned. It appears in nearly all of the schedules examined, although in a great variety of rates, running from one-twentieth of one per cent to one per cent for closing during the lifetime of the trustor, and from one per cent to two and one-half per cent where heirship is to be determined or inheritance tax work done.

Having examined the many schedules submitted and having considered the rates set up, the next point to be ascertained was whether or not the schedules as agreed upon in the various states were adhered to. The question on this point brought so many affirmative answers that it seems safe to say that the trust men have finally arrived at that happy state where fee cutting for the sake of obtaining new trust business is not looked upon with favor, although it seems generally accepted that concessions are made in return for favorable business in other departments.

Another interesting point brought out in the various schedules examined is the question of fees to be allowed co-trustees and co-executors. In general, there is an effort to provide that where there is a co-trustee or co-executor, the bank shall have possession of all personal property, shall keep all books and records, and shall collect all of the fee. Experience has shown that as a rule, where a bank acts with an individual, all of the

work is done by the bank, which should accordingly receive the bulk of the fee. Such cases are not numerous enough to call for extended discussion, and it is possible in most instances to reach an agreement without difficulty.

MANNER OF DETERMINING RATES

No review of the various fees charged in the United States can be complete without some investigation of the manner in which the rates were arrived at. After careful examination of the schedules at hand, a letter was sent out to each of the bankers from whom they had been received, asking for information as to whether or not a study of the cost of various forms of trust service had been made and whether or not the fees as set up in the schedules were based on such cost. Of the sixteen replies received, twelve stated frankly either that no such study had been made or that the fees as set up were not based thereon. In four cases, however, cost appears to have been used very definitely.

THE FEE SITUATION AT PRESENT

The subject under discussion having been thus reviewed, an analysis of the results of the investigations made may be set forth rather simply in a few paragraphs:

1. In those cases where fees are the subject of statute, a condition bordering on chaos exists; there is no uniformly accepted theory upon which charges should be based; even in cases where the same basis is used, the rates vary beyond reason; and in many cases, the statutes are not capable of simple interpretation.

2. Many states have no associa-

tions of trust men for the discussion of fees and other problems.

3. Among the trust companies there is no complete uniformity of practice as to the duties involved in various types of service.

4. In those cases where a considerable degree of uniformity of practice does exist, charges vary widely, and the rates having most general acceptance are the same as have been used without change for a great many years, regardless of changing conditions.

5. While there are many carefully prepared fee schedules in the country, in very few instances are these based upon a study of the cost of doing business.

6. In most instances where schedules have been set up, it seems an accepted rule that reductions will be made to clients of other departments.

POSSIBILITIES OF STANDARDIZATION

The first step looking toward standardization of fees would seem to be standardization of service; a definite understanding must be reached as to what is meant by a safekeeping account, a private trust account, an agency account, or any of the other various accounts which we are handling. Efforts along this line are probably a part of the present investigations being made as to the cost of service which should be carried through to their conclusion, and the committee now working on the subject for the Trust Company Division of the American Bankers Association under the very able leadership of Mr. Henry A. Theis will undoubtedly arrive at a conclusion which will be extremely valuable.

The next point of attack should be the present widely divergent statutory fees. To this end, it would seem

wise for an analysis to be made in each state to determine the length of time the present schedules have been in existence, the changes which have been made since they were first adopted, and the changes in the work involved in the handling of estates in those particular jurisdictions.

A SPECIMEN REPORT

As a specimen, a report based on conditions in the State of California is here submitted.

In 1861 the statutes based on the Probate Act of 1851 provided for compensation of 7% on the first \$1,000 of the estate accounted for; 5% on the next \$9,000, and 4% on all above \$10,000, with a further provision for extraordinary allowances at the discretion of the judge.

In 1881 the rates were changed so that a considerable reduction was brought about in the higher amounts, and a provision added that where an estate was distributed in kind and involved no labor beyond custody and distribution, fees on all of the estate above \$50,000 should be computed at one-half of the statutory rate.

In 1909 the rates were again considerably reduced and so remained until 1925, when a slight increase was made on large estates and the provision noted in the 1881 statute for one-half, in case of distribution in kind, was eliminated.

In order that the effect of the various laws, which have been in force in California may be quite clear, a tabulation has been made of the fees on estates of various sizes under the laws as changed from time to time.

Thus it is seen that the compensation of executors in this state has never since been as high as it was under the

laws of 1861 and 1881, although much has happened to increase the executor's duties during the years which have followed. In addition to the burdens that have been heaped upon executors all over the country by fed-

tions as to new, scientific, and easily interpreted laws, taking into account rising costs and new duties and permitting fiduciaries to charge suitable fees. The question of whether these laws should fix certain schedules of

Value of Estate	Executor's Fee under Laws of:			
	1861	1881	1909	1925
\$10,000	\$520	\$520	\$430	\$430
50,000	2,120	1,520	1,330	1,330
100,000	4,120	2,520	1,580	1,830
500,000	20,120	6,520	3,580	5,830
1,000,000	40,120	11,120	6,080	10,830

eral estate and income tax laws and by the taxation of intangibles in many jurisdictions, all of which are so familiar as to require no discussion here, and in addition to worldwide rising costs, the State of California is blessed with one or two burdens of its own. The inheritance tax which was adopted in very simple form in 1853 has been very much complicated since the passage, in 1893, of the first of a series of laws leading up to our present act, which was completely revised and broadened in its scope in 1905, four years before the second reduction in statutory fees. Changes have recently been made which materially reduce the taxes, but the labor involved in making reports and having the tax fixed remains. Also, during the past few years, there have been many changes in the personal property tax laws which, with the various revisions of the community property law, have further complicated the administration of estates.

NECESSITY FOR REASONABLE COMPENSATION

With such statistics at hand, it should then be possible to approach our lawmakers with definite sugges-

charges or should require the courts to determine what is proper in each case is still open to argument, and adherents to either side are ready with their reasons, some contending that all legislative price fixing is wrong, and others looking forward to a time when fees for testamentary trustees and guardians will be fixed as well as those of executors and administrators. Whichever course is followed, the legislative bodies should be reminded that the corporate fiduciaries are holding themselves ready to assume and are assuming a public duty, and that it is to the public interest not only that they be permitted to charge, but that they may be required to charge reasonable compensation.

THE PUBLIC MUST BE EDUCATED ON THIS SUBJECT

While endeavoring to bring about the education of the lawmakers to the end that reasonable, uniform statutory fees may be adopted, there is a tremendous amount of educational work to be done with the public to counteract a very general and unfortunate impression that an appointment in a fiduciary capacity is a sort of honorary appointment with no duties or

responsibilities attached to it. This feeling on the part of the public is probably an outgrowth of much which has been written, particularly in some of the novels of the last century wherein the individual trustee or guardian is held up as the benefactor of the widow and orphan. This idea is being fostered and kept alive by the news value of the unusual.

When the young widow succeeds in bringing the estate of her husband safely through probate, or when a daughter is equally successful with the estate of her father, and in addition, perhaps, handles the guardianship of her minor brothers and sisters, the commendation of the court and the laudatory comments of the press are fully deserved, but some method must be found to keep the corporate fiduciary before the public to the end that its value may be fully realized even though the smooth running of its well oiled routine cannot of itself attract attention.

Further, the people with whom we come directly in contact, the man or woman contemplating setting up a trust or making a will and the beneficiaries of our trusts should be made welcome in our trust departments, and allowed to see for themselves the care with which our work is done, and they should have explained to them the necessity for such careful work, and complete records, and the impossibility of doing the kind of work to which a trust is entitled without proper compensation. And let us not fail to look to ourselves, for if we are to receive adequate fees from the state, then surely the state may demand adequate service from us, and the institution which fails in this obligation injures not only itself but every other trust company as well; for if our suc-

cesses attract no attention, the slightest hint of dissatisfaction is magnified a hundredfold, a fact which we should consider a tribute, for it is the departure from the usual which makes it news.

Finally, in our educational efforts, let us not overlook the officers and executives of our banking departments; here the lesson to be taught is that there may be competition without price cutting. The railroads, to cite but one instance, have long competed freely under fixed rates, relying upon considerations of superior service to induce shippers to use the facilities of one road rather than another, and our corporate fiduciaries should look forward to a somewhat similar condition.

This course of education should include some instruction as to the undesirability of demanding reduced charges or free service in trust matters in the hope of inducing or holding business in other departments. If the officers of other departments were thoroughly familiar with the risks involved and the complicated nature of trust functions, they would probably be the first to insist that no such work be undertaken unless the company were properly compensated. Incidentally, can a case be cited where the loan department has been asked to waive its interest because the borrower has left his will with the trust department?

The purpose of this study is to throw some light upon a vexatious subject and to suggest some methods by which improvement may be brought about. Whether it has succeeded or not, no praise can be too great for the wholehearted, unselfish, and enthusiastic assistance which has been offered by trust officers all over

the country in supplying schedules and information.

SOURCES OF MATERIAL FOR THIS STUDY

Thanks are also due to Mr. Henry E. Sargent, secretary of the Trust Company Division, American Bankers Association, for much material and many valuable suggestions.

In addition to the fee schedules and information above referred to, the following authorities have been consulted:

Trust Company Law by John H. Sears

The Development of Trust Companies in the United States by James G. Smith

A Century of Banking in New York by Henry Wysham Lanier

A Trustee's Handbook by Augustus Peabody Loring

Directory of Corporate Fiduciary Associations, Trust Company Division, American Bankers Association

Prentice-Hall Trust Service

Prentice-Hall Inheritance Tax Service

Deering's Code of Civil Procedure of California

Articles appearing in the proceedings of various recent trust conferences by Roy C. Osgood, L. H. Roseberry, Henry A. Theis, W. Tresckow.

Discussion

THE CHAIRMAN: Mr. Garthwaite's remarks indicate a tremendous variation in the fees charged by our trust companies and banks throughout the country. It is no wonder that most of us are not quite sure

whether we are making or losing money. Perhaps a more careful analysis of our business would show that in many classes of our business we are losing money.

HUGH McLAIN (Colorado National Bank, Denver): Mr. Garthwaite, I was very much interested in your figures which indicated that nineteen responding companies were charging on income and fifteen on principal. I should like to ask whether you noticed, or whether you have any impressions as to the trend away from the income charge to the principal charge, or whether you have any opinion as to the desirability of one or the other.

MR. GARTHWAITE: That is a thing that has had a tremendous amount of attention in California. I think you all know that one part of California charges on principal and one part on income, and both ends of the state have their own views on the subject.

So far as the country as a whole is concerned, apparently the people who are using the various schedules are satisfied with the plans they have adopted and are not looking forward particularly to changing them. As to which is the best, it is hard to say. If we accept five per cent return as the average, obviously, five per cent on that is only a quarter of one per cent on the value of the corpus, while, as a rule, three-tenths is the lowest charged on principal, with the average around a half, which certainly gives the trustee a better return.

MR. McLAIN: Have you any impression as to whether the public takes to the income charge more readily than the principal charge?

MR. GARTHWAITE: My own experience has been that the public is

apt to hear the quotation of five per cent and immediately jump to the conclusion that their entire income is being taken in fees. It always requires a second step to explain that it is five per cent of the income and not five per cent of the principal that is being taken. I think that could be eliminated by using the other plan.

WILLIAM H. A. JOHNSON (Continental Illinois Bank & Trust Company, Chicago): Might I interpolate a remark on that subject? In Chicago we have both bases of fees; that is, it is optional with the trust companies whether to use an income or a principal charge. But we found that in certain cases we have to use income rather than principal for the reason that if we used the principal charge, we would take too great a percentage of the income. I know of one bank there that in taking in a trust recently that consisted solely of bank stocks which were yielding about two per cent on their market value, found that if they took one-half of one per cent, or a quarter of one per cent, as I remember the figures in that particular case, they would be taking about sixteen per cent of the income in fees. In that case the prospect immediately saw it and they switched to the income basis, purely on that ground.

Generally the Chicago trust companies, in the ordinary run of things, where the return is about five to six per cent, work on income basis rather than on principal basis.

DANIEL REIBER (Merchants and Newark Trust Company, Newark): What is your opinion as to how that fee might be divided if there is a co-executor connected with the bank that might be acting as executor and the bank does all the work?

MR. GARTHWAITE: I take it the fee that is received by the executor is for two things, for the work done and for the responsibility assumed. Any executor assumes a responsibility, whether or not he holds possession of the property. In California, the code provides that the fee shall be divided between the various executors at the discretion of the court. We have never had any difficulty in arriving at a decision, a satisfactory adjustment with a co-executor, but I cannot agree fully with the idea prevailing in the schedules that the corporate executor is entitled to all of the fee. I think the individual is entitled to some consideration.

MR. REIBER: You don't know what the usual percentage is? Have you any idea what might be the percentage divided between the corporate trustee and the individual co-trustee, if the corporate trustee does all the work and the individual co-trustee does no work, other than merely pass upon investments?

MR. GARTHWAITE: I think that would be very difficult to arrive at, because even if he passes on investments, he is doing some work.

HAL BANNISTER (Bank of America of California, Bakersfield, California): We had a case like that, and we took it before the court and asked the approval of the court; we were allotted three-quarters of the fee and the co-executor was allotted one-quarter.

HOWARD E. PARKS (Denver National Bank, Denver): Suppose that in May a year ago a trust consisted entirely of American Telephone & Telegraph stock. If the trustee had taken the fee at that time, the market would have been about \$320 a share; if he had waited until

November of last year to take his fee, the market price would have been about \$180 a share. On what basis do you take care of the fluctuations in market value when using the principal basis?

MR. GARTHWAITE: Some of the schedules make some reference to that condition. They provide that there shall be from time to time a reappraisement. In some cases they try to get around it by capitalizing the income and arriving at a value that way. I should very much like to hear from somebody who is familiar with the charging of fees on the corpus; I am not familiar with it. We do not do that in my part of California.

THE CHAIRMAN: Mr. Johnson, what do you do in Chicago?

MR. JOHNSON: We have not yet arrived at any really satisfactory way of doing it. We are still experimenting with several different ways of doing it and trying to find which is best. We have not been able to make up our minds.

R. C. LEMMON (Farmers & Mercantile National Bank, Los Angeles): We have not arrived at any definite solution of the problem yet, but I think we are in about the same position Mr. Johnson is in in Chicago. Everybody seems to be going at it from a little different standpoint.

THE CHAIRMAN: Mr. Hall, what are you going to do under the new schedule in Kansas City?

MR. HALL: Our schedule in Kansas City consists of about ten or twenty pages and it has been in operation only since March 1 of this year. I will have to say the same as Mr. Johnson. We have not decided as yet how we are going to do it.

THE CHAIRMAN: Is there any

other man here who works under a principal schedule who will help us?

JUDGE H. L. STANDEVEN (Exchange Trust Company, Tulsa): We operate under the principal schedule and we determine our fees according to the annual statement we render in each trust. For instance, we have an annual statement period; the trust is established on the first of May or during May; we make the annual statement as of the first of June each year, and the amount of that statement and the appraisement at that time fixes the annual fee for that period. Sometimes we render semi-annual statements, of course, but we use the annual statements for the purpose of determining the fees. It is in very few cases that we would have a large block of stock that fluctuated as they do in New York or Chicago or California. Therefore, we have not been confronted with that particular phase to any great extent. I believe our schedule is a satisfactory way in our country. We also provide that annual statements shall be rendered in our declaration of trust. We provide for an appraisement at that time.

May I make a remark regarding one of the other questions asked with reference to co-trusteeship? We discourage co-trustees in our country for several reasons. One principal reason was that the life insurance underwriters were soliciting on the basis that they would ask the wife or relative of the assured to become a co-trustee for the purpose of cutting down the fees to the corporate trustee. In connection with what Mr. Linton said this afternoon with reference to advising co-trustees, I think we accomplish that by what we call an advisory clause, by putting in the declaration

of trust a clause that we should advise with the wife or the leading beneficiary, and it accomplishes the same result, but the fees of the executor or trustee are not diminished in that way.

We find that the principal basis works more satisfactorily in our country than does the income basis.

We ran across the same question that was stated here and that was that one-half of one per cent of the principal psychologically sounds a great deal less than five per cent on the income. We have no trouble whatever in convincing our people that that is the proper charge and it has also been recognized by all the trust companies in the state and also accepted by our courts now.

THE CHAIRMAN: Do you apply the one-half of one per cent regardless of the size of the estate?

JUDGE STANDEVEN: Yes, sir; we have no fluctuation along that line.

THE CHAIRMAN: Is there any one else who would like to speak on this subject?

MR. McLAIN: There is one question on that last point, Mr. Garthwaite. Suppose you have a considerable amount of non-income producing stock, for instance, or other property that produces no income, such as non-income producing real estate. If one is on the corpus basis, how would that be handled?

MR. GARTHWAITE: I should think if there is no income, it would be a good deal easier to fix a fee on the corpus. You would have to fall back on a minimum charge if it were the other way.

MR. JOHNSON: Wasn't that one of the purposes of the charge? The trustee has the property and responsibility and is getting nothing for that service if you are on a purely income basis.

MR. GARTHWAITE: I will say some of the schedules provide in such cases that a charge running up in the neighborhood of five per cent shall be made on the amount expended in the way of taxes. That does not seem to meet the situation really.

The Legal and Moral Responsibilities of a Corporate Trustee

By WILLIAM H. A. JOHNSON

ASSISTANT SECRETARY OF THE CONTINENTAL ILLINOIS BANK AND TRUST
COMPANY, CHICAGO, ILLINOIS

Address before the Denver Departmental Conference

Although a trustee is not legally responsible for the adequacy of the security behind a mortgage or collateral indenture, it has, nevertheless, a moral responsibility. The prospective purchaser of corporate securities relies in part on the connection of the corporate trustee with the transaction. He assumes that, if in the opinion of the trust company, the project were not sound, it would not have accepted the trusteeship. If a default occurs and a loss is suffered, the investor feels that the trustee is, in part at least, responsible, and thereafter he will be unfriendly toward the company that acted as trustee.

The trust company that accepts shady business suffers an indirect monetary loss.

Mr. Johnson goes into the investigations which the trustees should make, the substance of indentures, the release of securities, the obligations of the trustee in cases of default, and so forth.

In closing Mr. Johnson says: "The liabilities imposed upon the trustee, moral or legal, can be reduced to a minimum by care in accepting trust business, and by acting under properly drawn indentures and strictly observing all of the terms and conditions thereof."

IN accepting what are generally known as corporate trusteeships, a trust company assumes moral as well as legal responsibilities. Trust officers have appreciated the legal responsibility and have taken legal advice as to the form of the indenture to prevent direct monetary loss to the trustee. Little attention has been given to the moral liability, and practically no counsel has been taken with regard thereto. Consideration is given to the publicity and possible direct monetary loss that may result from acting under a defective instrument, but none to the loss of good name and indirect monetary loss resulting from moral responsibility.

THE MORAL RESPONSIBILITY OF THE TRUSTEE

The prospective purchaser of corporate securities relies in part on the connection of the corporate trustee with the transaction. He assumes that if in the opinion of the trust company the project were not sound, it would not have accepted the trusteeship. The Blue Sky salesman knows of this assumption and uses it as a sales argument. The average trust officer thinks that the doctrine of *caveat emptor* should apply to the purchase of securities and that it is not the duty of the trustee to protect the public. If a default occurs

and a loss is suffered, the investor feels that the trustee is, in part at least, responsible, and thereafter he will be unfriendly toward the company that acted as trustee. When the trust company is sympathetic, which is a hollow thing when good dollars are in jeopardy, his faith in that trust company (and in trust companies in general) is shaken, and he is not inclined to do business with it in any of its departments; where possible he will even advise others not to deal with it.

TRUSTEE NOT LEGALLY RESPONSIBLE

It is axiomatic that a trustee is not responsible for the adequacy of the security behind a mortgage or collateral indenture. However, when a default occurs the security holder looks to the trustee for relief and reimbursement. One shrewd lawyer, knowing this rule of law, attempted to hold the trustee for a loss suffered by a client because of inadequacy on the ground of moral liability. The greater part of the brief on appeal was devoted to an argument as to the fact that average persons thought that the trust company had investigated the worth of the obligor and the adequacy of the security, and that because of this public impression the trustee was morally bound to determine these points, and having failed to do so was liable to investors in the event of loss. Fortunately for trust companies in general, the court held that it could not take cognizance of the moral duty.

The money lost in Blue Sky securities affects financial institutions in that it is withdrawn from banks and taken from the community by the pro-

moters; secondly, the small investor who has been "stung" becomes soured on securities and will not purchase legitimate securities from institutions in his community, or becomes convinced that he might as well spend his substance and have the benefit of his money rather than to save it and have some one take it from him with no return.

THE INDIRECT MONETARY LOSS

The trust company that accepts shady business suffers an indirect monetary loss. It will receive numberless letters from prospective investors inquiring as to the soundness of the investment and the recommendation of the trustee in regard thereto. There is an expense in answering such inquiries. Further, in the event of default the security holders call upon the trustee either in person or by letter to make good on the defaulted item. There is considerable annoyance and expense and a loss of prestige in explaining that the trustee is not bound to make up the defaulted payments and can do nothing. If there is a measure of security, however slight, it is a considerable task to arrange for the deposit of securities and the foreclosure under the indenture as there is no responsible underwriting group to form a committee. The ultimate realization for the bondholder will be small and he will again feel that the trustee is not treating him fairly.

TRUSTEE SHOULD MAKE NECESSARY INVESTIGATIONS

The trustee, before accepting an appointment as trustee, should investigate the obligor and the underwriter.

It should determine, as far as it is possible so to do, that the obligor is engaged in a legitimate enterprise; that it has assets proportionate to the amount of the securities to be issued; that the management is experienced; that there is a reasonable prospect of success in the business; and that the underwriters are reputable. The determination of these facts in the affirmative is as far as the trustee can go. Many defaults have occurred and losses have been sustained by investors in securities issued by companies with years of successful operation, but this fact does not justify a trust officer in blindly accepting each and every piece of business offered to him. The excuse that losses occur in old established enterprises and that there is no legal liability does not justify an utter lack of concern. In ancient times, Cain inquired as to his responsibility for his brother. Trust companies and trust officers are charged with the responsibility for their brother in the matter of finances.

The scope of this paper and the time allotted to it do not permit of an exhaustive statement of legal liability supported by an extensive citation of authority. An excellent summary of this phase of the subject by Louis S. Posner was published in the *Harvard Law Review* of December 1928. His paper, with the supporting authorities, covers sixty-three printed pages. The statements herein made will have to be taken on faith and the authorities supporting them investigated by collateral reading.

SUBSTANCE OF INDENTURES

The corporate indenture of today is a standard instrument. The phrase-

ology and arrangement of matter are peculiar to the craftsman, but the substance of all indentures is the same. They are drawn to relieve the trustee from liabilities that have been placed upon it by law on the theory of trusteeships of property where the trustee is vested with title and management. Such liability must be negatived in the corporate trusteeships or their acceptance would place upon the trustee possible liabilities that would be so hazardous as to preclude the acceptance of this class of business. There is a vast distinction between trusteeships where the trustee has title and control, as in personal trusteeships, and the trusteeship under discussion, where in effect the trustee is merely a title holder.

A trustee should never perform any act without carefully examining the indenture to determine the requirements precedent to the action to be taken. The obligor cannot be favored by waiving express conditions on the theory that an improper or unreasonable request will not be made or that the conditions stated are of little importance. In all cases the terms of the indenture should be followed exactly to minimize the possibility of liability. The obligor is given certain privileges, such as to withdraw insurance money, call bonds or release property. The right to do these things is primarily dependent upon there being no default at the time the privilege is exercised. The first fact to be determined is that the obligor has done everything required of it under the indenture, such as the maintenance of insurance, sinking funds, and so forth. Being satisfied that the obligor is not in default, attention may be given to the requirements relative to the thing to be done.

If action is taken without strict compliance with the conditions of the indenture, the trustee assumes a liability to the persons harmed by the action taken.

A TRUSTEE'S RESPONSIBILITIES

A trustee is not responsible for the adequacy of the security, but if there is security, it should be subject to the lien of the indenture. A trustee is bound to see to the recordation of a mortgage instrument unless the indenture provides that it is not responsible for recordation and may certify and deliver bonds prior to recording. In New York it has been held in a dictum that this release of liability does not apply to a re-recording of a chattel mortgage. Assuming that the release from liability is good, the trustee seldom delivers bonds until it has some evidence of recording, or in cases where personal property constitutes the security, the collateral is deposited with it.

Where additional bonds are to be issued under escrow or open end indentures, the trustees will be responsible for bonds that are issued without a full compliance with all the conditions prerequisite to such issue. It is, however, protected in acting upon certificates and documents presented to it evidencing compliance with the conditions, provided that it accepts them in good faith.

RELEASE OF SECURITIES

A trustee should never release any of the security unless releases are provided for in the indenture, and then only upon strict compliance with its terms. If an improvident release is made and the security holder suffers

loss thereby, he may look to the trustee. In rare cases releases of property have been made where the trustee was satisfied that the security was not lessened, but in so doing it assumed a liability in the event that its judgment as to the reduction of security was bad.

A final release should never be given unless the indebtedness has been paid in full. If all of the bonds and coupons are not presented for cancellation, a deposit of cash is made in lieu thereof or the missing obligations are satisfactorily accounted for. In some instances the trustee is not named as the fiscal agent and does not have a record of payment, but the responsibility is the trustee's to know that all outstanding obligations have been paid or canceled.

Underwriters are adopting the practice of naming a trust company as trustee and having themselves named as sinking fund and fiscal agents. The trustee does not know of its own knowledge that all bonds and coupons have been paid and is asked to accept a certificate from the fiscal agent as to payment. If the indenture does not specifically provide that such certificates shall be taken, the trustee should insist that the fiscal agent deliver the paid bonds and coupons to it for examination and cancellation. The good faith of the trustee in accepting certificates of payment, if payment were not in fact made, probably would not relieve it from liability if a release were given.

A nice legal question often arises as to whether deposits made under the terms of indentures are made with the trust company as trustee or as fiscal agent. It is generally held that if the deposit is made merely with a fiscal agent the obligor retains a

degree of control, particularly as to funds deposited for payment of current maturities of principal and interest, but that if the deposit is made with the trustee then the control of the obligor is lost on deposit and the trustee is responsible to the security holders.

CASES OF DEFAULT

In cases of default, the trustee may, but is not required to, take action to foreclose the indenture unless requested to do so by the holders of a certain percentage in value of the bonds and upon being indemnified against the expense to be incurred. Occasionally a slip is made in the drawing of indentures and instead of following the standard formula requiring a request of the holders of a percentage of par amount of bonds, the request must be made by a percentage in number of the holders of bonds. This latter phraseology is troublesome as the trustee may have difficulty in determining the extent of the distribution of the bonds among individuals, whereas in the case of a percentage of par amount it is always possible to ascertain the amount of bonds outstanding.

In case of lost bonds and coupons, reference should first be made to the trust indenture to determine what is required of the security holder before

new obligations can be issued. In general, bonds and coupons are negotiable instruments, and if payment is made to a holder, or duplicate certificates are issued on representation of loss, the original instrument may turn up in the hands of an innocent purchaser for value. In cases where an indemnity bond is required, it should be signed by a surety company rather than by individuals.

In mortgage indentures insurance is made payable to the obligor and to the trustee. In the event of a fire loss the trustee can release the money only under the terms of the trust indenture. If the provision is not made for the withdrawal of fire-loss moneys, the trustee is bound to hold them. The obligor cannot as a matter of right withdraw the money for replacements and repairs, nor can the holders of indebtedness demand that the money be used for the payment of the indebtedness.

The liabilities imposed upon the trustee, moral or legal, can be reduced to a minimum by care in accepting trust business, and by acting under properly drawn indentures and strictly observing all of the terms and conditions thereof. In short, do not in accepting corporate trust business, be a good fellow. The liabilities that are assumed should not cause fright, as they are easily avoided by taking legal counsel and using common sense.

Organization of the Probate Division

By PHIL D. HALL

TRUST OFFICER OF THE DETROIT AND SECURITY TRUST COMPANY.
DETROIT, MICHIGAN

Address before the Denver Departmental Conference

Two main themes are emphasized: first, the necessity of research methods in planning probate department organization in advance of the actual need; and second, the necessity of carefully choosing and training trust men for promotion.

Mr. Hall says also that it is impossible to develop a system in one company and then apply this system of organization to another company with fair hope of success; that the only common element is the method of analysis and research necessary to formulate a plan in any particular company.

This talk is based upon the analysis of all the material accumulated by the American Bankers Association, Trust Company Division, as a result of questionnaires over a period of several years.

The system discussed is a result of five years' research on the part of the speaker.

THE phenomenal growth of the use of trust services throughout the country has so emphasized the importance of this phase of banking that it has received major attention in banking journals, trust company periodicals, and on the program of every bank and trust conference. Many of us have felt for a long time that the superficial phases of trust activities have been overemphasized, that much reliance has been placed upon printed forms, and that the time has come for a rather careful study of fundamental principles. Systems are created, given widespread advertising, appear to the casual observer an improvement, are adopted in part or in toto, and then we wonder why they are almost universally discarded as failing to solve materially the problems of the trust department. I think the time is ripe for a new approach to the problems of trust company or-

ganization, an approach in which foresight and careful planning will supersede the hurried scramble to solve practical difficulties after the machinery has broken down and administration is in a chaotic jumble.

Through the kindness of Mr. Reuben A. Lewis, formerly Secretary of the Trust Division of the American Bankers Association, we have had the opportunity of studying for many months the material submitted by trust companies throughout the entire country, and that material indicates that the major problems of trust departments are not local but universal. Practically the same points of weakness may be observed everywhere. This has demonstrated to our satisfaction that future progress lies in the method of planning rather than in the plan itself. I want to emphasize two things in what I have to say: the importance of the research method in

solving organization problems; and the importance of choosing, training, and developing a personnel to carry out the administration of the plan once that plan has been created.

The term "probate division," as used in this discussion, will refer to that unit of the trust company or trust department whose chief duty is the administration of probate estates.

In discussing the probate division, I wish to emphasize the fact that practically all the principles which are considered in regard to making that department efficient and economical in operation may be applied just as well to every other division of a trust department or a trust company. The routine and machinery only will differ in the several divisions. It is practically impossible to use any system in its entirety in any two companies; too many local factors enter in, and only the basic principles may be adopted, the details being worked out in line with local conditions.

SIMILAR SET-UP FOR LARGE AND SMALL PROBATE DIVISIONS

In the beginning I am going to discuss a typical set-up for the largest type of probate division because in such an organization the highest degree of development can naturally be expected and realized, and I believe that we can demonstrate that the underlying principles which affect the organization described can be applied just as satisfactorily to the smallest probate department.

We find no wide discrepancy as to theory between the probate division of a small trust company and the similar units in the largest trust companies in the country. Only the routine of detail varies; the contacts are the

same; the responsibilities do not vary and the development of this department presents much the same problem in the older and in the younger probate divisions. Every probate department, regardless of how small it may be today, looks forward to the day when its business will be much larger and bends every effort to increase production in this line. Therefore, if we lay our foundation so that it will support the larger structure and adhere strictly to progressive fundamental principles in building it, the expansion will be a sound, easy, and efficient one, and you will not find in such an organization so many of those haphazard methods and routines as are bound to occur if the organization is added to and changed as the expansion of business requires without a well thought out and definite plan created in advance. It is no more logical to consider the building of a growing probate department without a definite preconceived plan based upon research and common sense, than it is to build a skyscraper, holding an architects' and contractors' conference to lay out each story as the work progresses.

If our advertising is to bear fruit, if our hopes for increased trust and estates business are to be fulfilled, we are all sooner or later bound to find ourselves face to face with the problem of establishing a division which can grow with the business and handle it economically and expeditiously as the business expands.

OVEREMPHASIS ON GETTING BUSINESS

With companies that have already reached a considerable size, we find that the chief weakness of the pro-

bate division lies in the fact that getting the business has been the primary aim and taking care of the business has followed as a secondary problem. The new attitude toward trust company organization is universally becoming an expectant one, and for the first time in our history we are realizing the importance of foresight rather than our former method of eternally trying to catch up in our routine in the face of rapidly increasing detail. I believe the new day in trust company service will show a marked improvement in this method and we will see a general striving toward building the organization so that its expansion may be a natural and not an artificial one, like a ramshackle house built room by room as a man's family increases. I think that one of the primary reasons for this change of plan is the fact that the educational campaign which has been carried on by trust company advertising has raised in the public mind a higher ideal of what trust company service should be, and our clients, as a result, expect today and will expect in the future a degree of service which has never been contemplated or dreamed of by trust company executives and employees up to the present time.

With the popular craze for production which our trust companies have borrowed from modern industry, we have emphasized quantity, and quality has suffered. As our organizations approach maximum size, it is found that this scheme of production leaves much to be desired, and like industry, we have come to realize that methods and results may be improved only by the application of studied research to the problems which have arisen, and which will certainly arise as the days go by. We are

changing from "line production" to the functional unit plan, and in this we follow the modern trend of industry. I sincerely believe that we are about to see a renaissance in trust company development. I feel that the opportunity for trained and ambitious trust men is greater today than it has ever been. To the man in this branch of banking business who is capable of methodical application of research methods, there is a present golden opportunity.

TYPE OF EXECUTIVE REQUIRED

The administration of probate estates is becoming a more and more technical activity requiring in the department personnel a type of executive which can be developed but which simply does not exist as a natural product to be plucked from the air when the need for that individual becomes manifest.

The trust officer of tomorrow must be a good salesman. He must be able to handle detail under pressure, if the need arises, and he must have a considerable complement of general business experience as a background if he is to be anything more than ordinary. When you demand, in addition, patience, tact, knowledge of the psychology of human contacts, and sufficient force to dominate a difficult situation, you have an ideal which is rarely, if ever, reached. Therefore, in choosing our raw material available for trust officers of the future, we must expect only the rudiments of these characteristics, and we must build our organization so that the experience which a man gains will emphasize and develop these characteristics and prepare him for his ultimate trust position. He must be

a young man with much ambition, and that ambition must be recognized and cultivated. He must possess ability to learn from his daily experiences, and considerable study must be given to furnishing him with the opportunity for such experiences. If his opinions, after he reaches an executive position, are to be of value and he is to have confidence in them himself—and such confidence is essential—his opinions must be cultivated and encouraged as he develops. Offhand I can recall no job in the banking and trust company field which requires more initiative than that of trust officer, and there is no human characteristic which is more easily discouraged, in training, than this essential element. Not only must appreciation of his ideas be shown, but time must be spent with him in developing the habit of research in formulating his ideas; the present executives have a heavy responsibility in seeking out among their employees those who have the foundational attributes and are capable of development; on the shoulders of the present executives rests the responsibility of developing those individuals to their fullest extent.

To the senior executives I wish to say that in the development of this individual you are working with a highly sensitive type of human being. The job in itself requires a high degree of sensitiveness and nothing but great care and attention to minor details on your part will develop this individual so as to bring out the characteristics desired. Encourage the presentation by junior employees of well thought out plans for improving company routine. A word of praise is always a debit on the ledger of company morale. Snap judgments

by executives are poor examples for the employee to follow. A little time taken in showing him how you analyze a situation will often later save you considerable time on a busy day.

To the young man whose ambitions lie along this line, I can only say that the job of trust officer is not only one of the most fascinating which is available, and as the idea of its importance grows remuneration will be adequate, but it is a job in which a man can never feel that he has arrived, because as the quality of service in the field improves, the man who seeks to advance must eternally improve with it. I can say with assurance that the progress in the requirements of trust company administration will make greater advance in the next decade than has been made in the past quarter century. The man who is to gain recognition in this field will have to work harder and make greater sacrifices as time goes on than persons in any other branch in the profession. His knowledge will have to be broader, his application will have to be more intense, and he will have to give more and more of himself if he is to keep pace with the ideals of the business. The organization which I am to discuss is built to assist in the development of this type of officer, and it is primarily planned so as ultimately to use this type of officer to the best advantage when that officer finally evolves.

OUR PRESENT ORGANIZATIONS ARTIFICIAL IN MAKE-UP

I have said that one great fault of our present organizations is the fact that they are artificial in their make-up. They are a heterogeneous mass of expedients which are loyally de-

fended because of their antiquity. The easy way is always the hard way to discover in corporation methods. In the old days when we lived in log houses we used to invite in the neighbors to put the house together. Imagine a house built like that today. Just imagine the plumbing, the heating, the ventilation, the architecture, the interior decoration conceived and executed on the job by the well meaning neighbor, the butcher, the baker, and the candlestick maker.

And that is the way we have organized our banks and trust companies. The financial department issues, perhaps, rules as to the conduct of trust department employees; men remote in their work and experience dictate the choice of trust men for promotion; an officer in another department lays out the bookkeeping and accounting plan for the trust organization; or the treasurer is sent to visit other companies to gather knowledge as to how trust records should be kept. Some one makes up a satisfactory form for recording rent collection, and the next thing we know, on the strength of that success, he is the official form designer for the company and blossoms out with plans for everything from security vault records to an absence and tardy record for the janitors. The fecundity of these individuals is equaled only by the havoc they can cause.

This "dumb" but eager method of designing results in such happy ideas as putting all the trusts with odd numbers in one ledger and all the even ones in another, or perhaps arranging transfer binders according to the date the sheets were withdrawn and not numerically or alphabetically, so that tracing the history of a trust is a self

conducted tour through a dozen hefty volumes, like Dante's famous travelogue.

THE RESEARCH METHOD

We have repeatedly referred to the research method of solving these problems. There is nothing unique in this; it is simply based upon that old and primary theory of logic: "Examine that which is known, project that knowledge into the future, and reconstruct that which you have at hand to accomplish the ideal." It is my purpose briefly to pick apart and dissect present methods that we may discover the weaknesses which are most noticeably universal. This is not done in the spirit of criticism but with the purpose of showing that much that we consider to be fundamental practice today has been hastily conceived and is quite frequently based upon fallacies. We can have no sympathy for that attitude of mind on the part of executives or junior officers which insists on letting well enough alone; this attitude is a relic of the dark ages of trust administration. No trust organization which is satisfied without having each day show marked improvement will keep pace during the next generation.

One of the primary objectives I had in mind in organizing this talk was to make it of some practical value to the man who is face to face, or will be face to face, with the problem of organizing or reorganizing a probate division so that it will operate economically and efficiently. I am not talking primarily to executives in making the suggestions because, very frankly, I realize that the details of any successful reorganization of a probate department or any other trust

department must be handled by men who are more familiar with and closer to the actual details and problems of operation than any executive can, in the very nature of things, be.

Let us be consistent and apply the research method to this problem, but let us resolve, however, before attacking it that we will absolutely put aside personal interest and maintain the company's and client's interest as our viewpoint throughout the task. Let us also realize that we will not criticize any method or procedure unless we are able to substitute a constructive suggestion to take its place. Let us bear in mind that our attack is upon methods and has nothing to do with individuals. Unless this attitude of mind is strictly adhered to, it is absolutely impossible to break down the inertia and prejudice and habit that exist in every established organization. When that organization finally appreciates, from top to bottom, that the motive for your efforts is the welfare of the company and the client and that you have put your personal desires and ambitions entirely out of the picture, then, and only then, can you wear down the perfectly natural resistance that any comprehensive change in operation will naturally meet.

UNIVERSAL WEAKNESSES

In analyzing the material which we have had available, through the cooperation of the American Bankers Association, we find that the following weaknesses are almost universal. In attacking your own problems in your own company you may use this list as a starting point. You will probably find that some of them do not apply to your organization and

you may also discover others which are not mentioned here.

1. The client has the impression that the administrative officer is too busy to give courteous, proper attention to the client's business.

2. Important details are neglected, and dangerous and expensive errors are possible, due to the excessive load of detail upon administrative officers.

3. Estates are administered in a haphazard manner as time allows. The administrative officer cannot be expected, under the present situation, to take time to analyze important problems in advance or to prearrange the administration of his estates. Judgments are, under the present set-up, apt to be snap judgments and are subject to a large percentage of error.

4. Individual estate administration is not properly laid out and planned.

5. Insufficient time is available for the direction and supervision of clerical help. Errors are discovered by accident. Auditing is a check-up on individuals and details and not a check upon methods.

6. Too often administrative officers have only a vague idea as to the actual status of an estate.

7. Clients object that details which are important in their eyes are considered of minor importance to officers and sidetracked because of their burden of detail.

8. Important matters of policy are not discussed with senior officers because both administrative officers and senior officers are pressed for time.

9. Present printed forms are hastily conceived and cumbersome to use. They tend to increase administrative officers' duties and are dangerously inaccurate if relied upon.

10. Administrative officers all feel that they are spending the major part of their time on work which should be delegated and they are neglecting details which they should study and analyze.

11. The company is paying ad-

ministrative salaries for the performance of much clerical work.

12. The spasmodic attempts to improve the present condition have failed largely because they tend to increase administrative officers' duties and not to relieve them.

13. Too often plans for the improvement of probate division routine are put into effect without proper research and usually without any attempt to correlate their functioning outside the confines of this single department. The several divisions of the trust company have grown up as distinct departments rather than as an integral part of a unified organization.

14. No definite plan has been evolved to allow for the expansion of business. The present method consists of adding to the list of officers as business increases; this is expensive and tends to confuse rather than clarify administration.

15. If an administrative officer has to devote his entire time for several days to the solution of an important problem or an emergency, he does so at the cost of demoralizing all other estates in his charge.

16. The lack of standardization of procedure makes it very difficult to transfer partially completed administrations from one officer to another.

17. It is impossible for other departments to cooperate with a number of different officers who operate in as many distinctly different ways.

18. There is no adequate check upon administrations in general to prevent drags in the completion of the work and to determine the quality of each officer's efforts.

19. The choice of junior officers and the determination of those who are to be promoted is based upon social acquaintance or personal impressions and is often decided by influence foreign to the trust department.

20. Important information is carried in the heads of officers and clerks and is not available as a permanent record.

VIEWPOINTS IN CONSIDERING IMPROVEMENTS

Now, having in mind the weaknesses present in the organization we are working upon, let us bear in mind four distinct viewpoints from which every suggestion for improving the organization must be considered.

1. The company's viewpoint
2. The client's viewpoint
3. The court's viewpoint
4. The administrative officer's viewpoint.

The company must be sure that:

1. It promotes the client's good will
2. Its organization is thorough, speedy and economical
3. It uses executive, administrative, and clerical effort to the best possible extent
4. It prevents overlapping of departments
5. It provides adequate and accurate records available upon demand
6. It chooses and trains subordinates for future promotion upon a basis of merit only
7. Every step taken tends to improve company and department morale.
8. Adequate, timely information is obtained to determine whether or not business is to be accepted, and to permit its proper assignment to the several administrative officers.

The client demands:

1. Prompt results in administration
2. Available, accurate information on demand
3. Contact with a minimum number of persons
4. Understandable accounts
5. Uninterrupted, unhurried, and courteous contacts with officers.

The court demands:

1. Complete and accurate information on all papers filed and

the statements made by company officers

2. All documents filed on time
3. Concentration of court contacts in a minimum number of company representatives who are familiar with court routine.

The Administrative officer desires:

1. Freedom from the greater portion of present detail
2. Elimination of useless and cumbersome forms
3. Instant availability of information as to the status of any phase of the estate administration
4. Proper follow-up to prevent dragging of administration
5. Fool proof records as to disbursements, assets, investments, liabilities, claims, and overdrafts
6. That the senior officers' contact with administrations shall not be limited to instances where estates go wrong
7. That remuneration and promotion be based upon merit alone.

Having the foregoing in mind, let us consider briefly the organization for the actual administration of an estate. Beginning our study of the organization let us bear in mind that the rate of administration as to elapsed time is determined by statute, and that the ideal organization will be such as to complete the administrative task within approximately the prescribed period, each step tying into the sequence of court procedure.

EXPLANATION OF THE CHART*

We have placed in your hands a chart indicating the statutory elements which determine the time necessary to administer a typical estate under the laws of the State of Michigan. You can easily construct such a chart to comply with your own statutes.

Let us examine this chart for a moment so that we may have a common understanding of this factor of time. On the vertical line shown on the chart, one inch represents a thirty day period. Starting with the day of death we find that a period usually elapses before any definite action is taken toward the probating of the will or the opening of the administration; this we may term, for want of a better name, the "respect period." It has been my observation that this period is growing less and less as years go by. Let us say that approximately thirty days after the date of death, the petition for administration or the probate of the will is presented to and filed in the probate court. In a typical estate the date of hearing set for this petition is advertised for a period of three weeks, and at the hearing testimony is taken supporting the petition and proving the jurisdictional facts necessary to establish the court's right to administer the estate. Testimony is also taken to permit the admission of the will to probate if the deceased died intestate. If this testimony is satisfactory the administrator or executor is appointed. He is ordered to give a bond in an amount within the discretion of the court and letters of administration or letters testamentary are issued to him.

Commissioners on claims, who will decide upon the debts properly charged against the estate, are then appointed. Under the Michigan statute the date set for the hearings on claims is advertised for a period of three weeks. The first meeting of the commissioners on claims is usually two months and the second meeting cannot be less than four months from the date of the commissioners' ap-

* Those interested may secure a copy of the chart by applying to Mr. Hall.

pointment. Having heard all the claims, the commissioners file a warrant and report in the court and any disgruntled creditor is allowed a period of twenty days in which to appeal.

It is usually the practice to prepare and file the final account at this time and the hearing on this final account is advertised for a period of three weeks.

The inheritance tax is determined and paid in the meantime, and if the final account is allowed and there is no appeal, the court orders the distribution of the estate; upon presentation of proper receipts for the residue of the estate, an order is entered by the court closing the estate, discharging the executor or administrator, and canceling the bond.

Thus the statute determines that the average estate can be closed, if no complications arise, in a period of approximately eight months. There are statutory exceptions, but they are not the rule. A study of a great many probate files indicates that the average time consumed in the administration of a typical estate is approximately one year.

COMMITTEE FOR FORMULATING THE PLANS

We have found in our research that there may be as high as fifteen hundred individual items which it may be necessary to check in the administration of an estate. These, of course, do not all occur in any one administration but have been found to occur in some of the administrations of the hundreds of estates studied. The chart furnished you states only those which determine the statutory time necessary for ad-

ministration. It is not our purpose to go into these steps in detail, but when you attack the problem of reorganization of your probate division, it can preferably be done by listing all possible items in a card catalogue, so as to allow their rearrangement and allocation to the several divisions of the probate division which you determine to establish. This method permits you to take your present organization and distribute detail duties to the organization in the best possible manner. I would advocate, in doing this, that you first arrange for the appointment of a correlating committee representing your probate division, your auditing division, accounting and bookkeeping division, a trust officer familiar with trust administration, and one senior executive. If you have an investment and a statistical department, they should be represented on this committee. This committee cannot be chosen too carefully. The men chosen should be willing to work, should be familiar with the detail of their divisions, and, if possible, should be open minded toward the improvement of the entire organization.

It has been found that a representative committee such as this can institute changes with far less resistance from officers and departments than if it is attempted by any one individual, and the greatest advantage is that no plan will be formulated which appears expedient in one division but which will seriously interfere with the routine of another unit. All memoranda as to methods and procedure should flow through this committee.

In so far as possible, the executive officer chosen should be the mouthpiece of this committee although he should be the type of officer who is

willing to give sufficient credit to his assistants so that they will be constantly encouraged in the difficult task they are attempting.

As to the organization of the divisions, these rules should be borne in mind: that the changes should create the least possible confusion; that the changes contemplated should be put into effect over a period of not less than three years; that definite results should not be expected by any one within a period of four or five years, although there will be many beneficial results visible during this period to those familiar with the department.

In our organization in the Detroit and Security Trust Company we have established ten divisions. Several of these divisions have subdivisions within themselves. We have, in addition, established a central index around which the entire system revolves.

THE RECEPTION OF A NEW TRUST

In the reception of a new trust, it is first analyzed by the officer conducting the initial interview, and a memorandum for trust assignment is prepared in duplicate. The officer conducting the initial interview then recommends the acceptance or the non-acceptance of that particular piece of business. If he recommends it, he discusses the business, and presents the memorandum for trust assignment to certain designated officers. If it is then decided to accept the business, it is assigned to an officer who is particularly qualified to handle it, or, if it is a somewhat routine piece of business, to the officer who has the time available for the new trust.

Thus the new trust cannot be accepted or a trust number given to it until it is approved by two officers, and in this method of approval we have checked by two officers the title of the trust, the sub-title, if any, for cross reference, and the capacity in which the company will act, eliminating in this manner most of the very embarrassing errors in the set-up of the particular trust. When the trust is given a trust number, an addressograph plate is prepared, carrying the title of the trust, the trust number, the name of the officer in charge, the capacity in which we are to act, and a sub-title for cross reference if required; using the addressograph machine permits the duplication of indices at will with minimum expense and eliminates the possibility of troublesome errors which occur when cards are typed and retyped.

Each officer has in his desk an alphabetical and numerical list of his own trusts. In addition to this he has available the assistance of the central index in locating any piece of business or answering any inquiry. The two clerks in charge of the central index have complete charge and responsibility for keeping all the indices in the building up to date and in order.

When the business has been accepted, an interview is arranged by the officer in charge of the trust, with relatives and attorneys, to obtain the preliminary information necessary to start the routine of administration. He has available certain printed sheets, and it is found that by asking the questions there indicated and filling out the blank spaces provided, in twenty minutes the officer or his trust aide can obtain almost all the information that is necessary to set up properly and to administer the

trust. In this manner we avoid frequent interviews for items of minor importance which were never obtained in an orderly manner under the old haphazard methods. While this takes a little time at the beginning, it saves an immense amount of time later in all the divisions. Once the trust is in operation it provides information so that each division can start operating at once. It gives the administrative officer a picture of the trust which he can obtain in no other way and, incidentally, it impresses the clients and their attorneys with the fact that this administration of estates is a complicated and technical job and that the company is attacking the problems in a thorough, systematic, and efficient manner.

On the preliminary information sheets certain items are preceded by designating numbers, and when the secretary or stenographer of the trust officer fills out the preliminary information on the work sheets for the several divisions, she puts on each of those work sheets the specific information which that division requires. Thus, automatically, this information is promptly delivered to each division and that division receives only that information which is pertinent to its particular task. The plan also furnishes to each officer a work sheet which arranges, in logical sequence, the duties which he has to supervise. As we have said, each of the ten divisions has its own work sheet, and the plan is worked out to such a degree that the performance of a single act by the administrative officer will start in rotation the wheels of each interested division and when the activities of the divisions in regard to that particular item are completed, the attention of the administrative of-

ficer is automatically called to the completion of the task. The work sheet of each division acts as a tickler and follow up on each of the other divisions and upon the administrative officer himself, because negligence in performing a duty in any one division will promptly be felt in the slowing up of the other units. In so far as possible we have prevented duplication of effort and have cut down the routine and rerouting of journal entries and other memoranda to a practical minimum.

THE TRUST AUDITOR

The system is unique in one feature in that we have created the office of trust auditor. When the work sheets for the several divisions are ready for distribution, they, together with any memoranda or ticklers for remittance and accounts, are routed over the desk of the trust auditor for a preliminary checking and then distributed by him to the several divisions. The trust auditor and his assistants check the status of each trust at stated periods to see that no division is failing to perform its particular duties at approximately the predetermined time.

The work sheets of each division and each trust officer are kept in uniform binders and are available to the officers and their aides at all times. All printed forms are of uniform size and perforated to fit these binders.

The system requires that after the work sheets of all the departments have been certified as completed, they are returned, together with the work sheets of the officer in charge, to the trust auditor, who gives them a final check and then places them in the

trust file as a permanent record. At first glance this system will probably seem to you unduly complicated and expensive, but because of the fact that it is perfectly natural and operates in a logical, normal way, it is already, after an experience of two years, operating so smoothly that we wonder how we ever got along without it. Instead of being expensive, it has allowed us to absorb a 100% increase in business with no increase of administrative officers, and at present our administrative officers are supervising approximately two hundred trusts apiece. One officer and his assistants are handling satisfactorily in excess of eleven hundred agencies. We have been able to decrease the number of printed forms required in the office by approximately 30%. The task is far from completed and we anticipate that the plan will be systematically modified and simplified as time goes on.

The chief difficulty which we are now encountering is in weaning away our officers from the details which they still insist on doing as a matter of habit. We have provided the means for delegating these duties, but you all appreciate how hard it is after doing things in a certain way for many years to rely upon somebody else to do those things and confine yourself to matters of supervision and control.

TRUST AIDES

In passing, it might be of interest to mention that each officer has a trust aide and it is contemplated that the number of these trust aides per officer will be increased so that it is possible to look forward to the time when each administrative officer will

be handling far more accounts by confining himself to strictly supervisory and executive duties, when each officer will be available in an emergency for advice and discussion, available for contact with clients on important items and able to sit back relieved of detail and with ample time for the analysis and study of problems before those problems become acute.

When you contemplate the establishment of an organization similar to this and, very possibly, better than this, in your own company, it may look to you like an impossible accomplishment, but we have found that the natural resistance of departments and individuals toward change and a natural resistance of departments toward reorganization of their routine can be worn down by a constant, quiet, self-effacing program carried out by a coordinating committee along farsighted, patient, and logical lines. You will probably find that, slow as the process may be, it will be necessary from time to time to slow up the program in order that its educational features may take effect and to allow the officers and divisions time to catch up with the program.

The chief danger which I might point out is in the impatience of your executives for results. Most of the systems which fail, fail because they are hastily conceived and hastily put into effect. They are not planned in advance for the need, but are worked out in the confusion of a department which has broken down under a peak load of business which the organization is not prepared to handle.

To many of you who represent smaller organizations, it may appear

that we are exaggerating the problem and unduly complicating the machinery, but I am personally convinced that an adherence to the principles outlined will solve the problems of any probate division, regardless of how large or how small it may be and whether comprised of one man or several hundred men. The allocation of the necessary duties will be the chief problem which you face. In a one-man department, that man will necessarily do what in the larger organization is done by many, but the business of the small department will be small enough so that he will be enabled still to function to advantage, and as the department grows, procedure will be sufficiently standardized so that the accounting division, the statistical division, the auditing division, and the other units, as they are developed, will not find themselves in the position of trying to co-operate with ten or twelve different officers, all of whom operate in their own individual manner.

EACH INSTITUTION PRESENTS AN INDIVIDUAL PROBLEM

It is not thought wise in this discussion to explain further how any particular company performs any individual function because we have seen nothing but disaster arise from attempts made to adapt one company's system to the accomplishment of duties by another. There are so many factors which enter into the establishment of practices in one organization which are absent from or entirely different in another, that the adoption of some one else's plan, when grafted upon another organization, results in an artificial, unwieldy machine. The only feasible method in

approaching the organization or reorganization of a probate division is to analyze by careful research all of the factors which affect that organization's operation, to have clearly in mind what one seeks to accomplish, and then using the material at hand with a minimum of adjustment, so systematically to revise procedure that in due time the desired result will be obtained. The danger lies in attempting to solve one problem as an isolated item without having in mind a definite plan for the entire organization. This planning in advance is the hard way and the slow way; it is the method which will meet with the most impatience from officers anxious for results, but it is the only way which will create an organization which will operate easily, permanently, economically, and efficiently.

Discussion

HUGH McLAIN (Colorado National Bank, Denver): Mr. Hall, have you formed any opinion in your research as to how many estates a well trained trust officer can efficiently handle?

MR. HALL: There are a number of factors that affect the answer. First of all, there is the ability of the individual trust officer, but the real test is this: Of how much of the routine detail can the organization relieve him? If he is loaded down with detail, he is probably limited to the proper administration of a small number of estates. We have been able to accomplish this: Our average trust officer in the Detroit Security and Trust Company is handling approximately 200 estates, largely in a supervisory capacity. On the other hand, we have one officer who is han-

dling, with the assistance of two trust aids, 1,500 agencies, which are more or less routine, of course. That is probably not possible as far as actual probate administrations are concerned, but the number of estates one officer can supervise is determined by his freedom from detail and the proper qualification and training of his assistants.

R. C. LEMMON (Farmers & Mercantile National Bank, Los Angeles): Mr. Hall, what is your organizational set-up? You said you have ten different departments, I believe.

MR. HALL: There are ten divisions and several of those have subdivisions in our organization. If I recall correctly, we have an organization there of about 600 employees, all engaged in some phase of actual trust administration. Those 600 employees are divided into ten divisions. We call them divisions; we do not encourage the idea that they are independent departments. We have a trust department organization of officers as one unit, which is a supervisory division, and that unit is working with an accounting division, an auditing division, a statistical and investment division, an inventory division, a claims division, a collection division, a real estate division, a tax division, and an insurance division. I am going to make a suggestion. In the booklet which the American Bankers Association published on the recommended plan for administration of trust duties, these divisions are all listed with the work sheets for each, and out of those you might get the list of details that have to be done; but do not pay any attention to how the details are worked out. You have to take the problem in your own department on the foundational prin-

ciples we have discussed and determine your own system. You cannot use anybody else's system, but you can get the details you have to allocate to your different departments.

HAROLD WAGNER (International Trust Company, Denver): Mr. Hall, I note that you say you cannot go out and get administrative officers on a Monday morning when business happens to be better than usual. How do you expect the probate division to train people to go ahead with the work when it is necessary to make additions or changes?

MR. HALL: That is treading on dangerous ground, but I think I can say in answer to that question: Start your education with your senior executives. How you are going to teach them how to pick a man who will develop, I do not know; that is somebody else's problem. But having picked that man, then get just as far away from the bank idea of training a man as you can, because the bank system is to put some man in a job and when he gets good in that job, to leave him there. Since he is the kind of man who will stay put, he is the kind of man who will be annoyed if anyone working under him gets a new idea. He will slap him back into line every time he gets a bright idea. You know there is nothing in the world that will kill initiative and check the development of ideas better than that. You slap him into line often enough and you will build a typical trust and bank man out of him until you get him along to a point where he is a top sergeant. Then you haven't anything to bridge the gap between the colonel and the top sergeant.

Then one of the colonels dies or moves out of the organization. You

need a new colonel. You have nobody to choose but top sergeants. So you pick a top sergeant; I don't know how, but you just pick him. You put him in the colonel's office. Then you expect that individual who has been slapped into line all this time to just blossom out into a full-fledged executive. It may happen some time; I am waiting, in the hope that I will observe that miracle. But if we can get these men along the line so that they do not slap everything we want out of the men under them, and so that they will take a little time to develop them all the way along, and if we will bridge this gap between the top sergeant and the colonel, we will have solved our problem.

JOHN D. ADAMS (Union National Bank, Troy, New York): I should like to ask Mr. Hall how he bridged the gap in organizing the estate for probate between the informal work of familiarizing himself with the decedent's affairs and the work of putting his affairs on the books of his bank in the proper form that good banking accounting requires. That is, it may be a matter of several months before you are ready to determine just what a man's estate is worth, what his different assets consist of, and yet your statements as required by the Comptroller of the Currency now would like to have you append to the bottom of the bank statement your trust department balance sheet, and state in dollars and cents the corpus and the trust assets. I am afraid some of the returns that are made are such that those valuations of trust assets must be subject to a great deal of revision before you are thoroughly familiar with the man's affairs.

MR. HALL: You have covered

a great deal of territory. I think I can answer part of your question.

I will say this as to getting the record on the books—that is a universal weakness in the set-up of almost every trust company whose routine forms and methods we had a chance to study. There was a drag in the forming of the inventory first that doesn't seem necessary, but it is an ever present evil. We have tried and have made some progress in overcoming it. It is still one of our weak spots. The other drag is in closing an estate. We are working on that, but I am not talking about it in public yet. I want to bear in mind what Mr. Linton said yesterday about ignorance stimulating the imagination.

We have tried to bridge that gap before filing the inventory in this way: We have a set-up of questions on the officer's preliminary information sheet which he takes with him into the conference with the family and with the attorney on the very first interview. This is a complete set-up of the information which we have found every division in the place will need.

We divide all estates into three types: probate estates, administrations, special and general, and executorships in one group, with a set of sheets for every division right through; in another we have guardianships under court order, and trusteeships under a will, and testamentary guardianships, with another set of sheets straight through; the third group is the agencies and living trusts.

So that just as soon as the officer decides into which group the particular job falls, he tells his secretary; she brings him that administrative sheet, if it is an administration. He fills out his preliminary information sheet and hands that back to his secretary. She

gets the proper sheets, fills them out with the information which should go to each division, and to each division goes only the information which it needs. Then those are distributed and each department starts right out.

E. FLOYD GRIFFIN (Oyster Bay Trust Company, Oyster Bay, New York): Mr. Hall, where may one obtain a list of the steps in administering an estate which would be of assistance in collecting and organizing a trust department?

MR. HALL: I said a moment ago that if you get that little booklet which the American Bankers Association, Trust Company Division, was so kind as to publish, you will find in it all of the work sheets that we had at that time. You will find in it listed on those sheets, all of those details which we had found up to that time, about 1500 of them. If you just use that as a list of details alone and if you do not attempt to get anything more out of it, it is all right. Do not attempt to apply it to your own organization because we have seen a couple of disasters in trying that.

NATHAN B. FOLSOM (The Mahoning National Bank, Youngstown, Ohio): Do you take any estate that is offered, and if you do, do you have a minimum fee? If it is more than the statute, do you have any trouble?

MR. HALL: Until six months ago, we took them all. Then we began doing a little research on the thing and found out there were a lot of estates we were actually losing money on. They looked good when they came in and the salesman or solicitor for new business was enthusiastic over them and said they were good. When we got such an estate on the books, something happened to the stock market or something. So now when any

piece of business is offered to us, we have a memorandum for trust assignment and on that sheet certain information is put down. If the man who has the initial interview then recommends it for acceptance, he takes it to certain designated officers who go over it with him and he has to sell them on the acceptance of the trust. If they then agree that it should be accepted, it is ready for assignment to an officer and is put on the records as a new piece of business.

We are attempting to go so far as to have wills that are offered us analyzed for acceptance before they are accepted. I think that the time is coming when trust companies can talk freely about business that they want and business they cannot afford to accept.

One bank has shown a little intelligence and courage. It has come out and said, "There are certain kinds of accounts we do not want; if we have them, it is going to cost money to keep them. There is a certain minimum we cannot go below; if we do, we will lose money. We do not want business that is unprofitable to us because that kind of business does not get proper attention."

That is true in a trust department. If throughout the organization everybody knows that a particular piece of business is a money loser, that piece of business is always sidetracked for good pieces of business, and it suffers. It is the kind of business that always brings you criticism and that costs you a lot. You cannot afford to take business that is not profitable.

I think the time is coming when we are going to be able to speak out and say we cannot take that kind of business because we cannot handle it properly.

Legal Pitfalls in Accounting between Life Tenants and Remaindermen

By JUDGE H. L. STANDEVEN

EXECUTIVE VICE PRESIDENT OF THE EXCHANGE TRUST COMPANY,
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Address before the Denver Departmental Conference

Judge Standeven, in discussing the legal pitfalls in accounting between the life tenant and the remainderman, says: "Too frequently there is no guide provided either in the trust instrument or in the law, and he [the trustee] is forced to act at his peril, unless he first obtain judicial sanction for his conduct. Perhaps nowhere in the administration of the trust is the trustee faced with more delicate problems than in the apportionment of receipts from and charges against the trust fund between the life tenant and the remainderman." Judge Standeven presents not only specific laws governing such cases, but also specific cases in which the decisions are of importance.

In connection with the handling of dividends from corporate stocks, he explains the workings of three rules commonly used in deciding such cases: the Massachusetts rule, the Pennsylvania rule, and the Kentucky rule.

He considers such subjects as rights and options; liquidation dividends; amortizing premiums and accumulating discounts; oil and gas royalties; increases in live stock and personal property; insurance; taxes; inheritance taxes; brokerage; and a uniform principal and income act.

ONE of the principal functions of the trust company is to give greater certainty and facility to the administration of fiduciary relations. The conduct of the trust company or other trustee in this respect is governed by the trust instrument, the statutes and the decisions of the courts. For his own protection and for the protection of the trust estate, it is important that the trustee have explicit instructions either in the trust deed or in the law governing the administrations of trusts. Where the instrument creating the trust indicates the trustee's duties with care and accuracy, there is, of course, no need for discussion. But too frequently there is

no guide provided either in the trust instrument or in the law, and he is forced to act at his peril, unless he first obtain judicial sanction for his conduct. Perhaps nowhere in the administration of the trust is the trustee faced with more delicate problems than in the apportionment of receipts from and charges against the trust fund between the life tenant and the remainderman. The trustee holds as much for the protection and benefit of those entitled to the remainder as for those to whom the immediate beneficial enjoyment is given. It is his duty to execute the trust impartially, consulting the interests of both parties. If he neglects this duty either

to the one or to the other, he may be required to respond in damages to the injured party.

NO SATISFACTORY DEFINITIONS OF TERMS

Ordinarily the trustee's duty is to pay the income and profits from the trust to the life tenant in accordance with the specific instructions of the settlor or creator of the trust, while he preserves the corpus or principal of the estate for the benefit of the ultimate remainderman. The difficulty arises, however, when the testator or settlor does not expressly stipulate just how the apportionment shall be made, but uses such words as "income," "net income," and "issues and profits" in describing the interest of the life beneficiary. As our industrial and commercial life has become more complex, the distinction between capital and income has become less and less clear. No precise definition of income as distinguished from capital can be enunciated. Capital, according to Professor Irving Fisher in his treatise "Nature of Capital and Income," is a fund or property existing at an instant of time, while income is a flow of services rendered by that capital, such as the payment of money from it or any other benefit rendered by the fund through a period of time.

But definitions of these terms which satisfy the modern economist will not furnish a guide to the trustee who is faced with the duty of apportioning a specific fund in such a manner as to pass both the economic and the legal test. From the standpoint of the trustee, such a definition should be a sort of rule of thumb which could be applied with certainty and with dispatch. Unfortunately, the law falls

far short of declaring an unambiguous and reasonable test adapted to the ordinary needs and duties of the trustee. The trustee's action in any case is determined by two factors, namely: His duty to act impartially between the life tenant and the remainderman; and his desire to protect himself from liability for a wrongful distribution. In his discussion of the proposed "Uniform Principal and Income Act" at the recent Trust Conference, Dean Clark remarked, as other writers have, the tendency of the law to favor the remainderman at the expense of the life tenant. If such a tendency exists it may be traced in part to the reluctance of the trustee to debit the corpus of the trust with doubtful charges whereby he may incur liability. In his zeal to observe the equitable maxim that the corpus of the estate must not be diminished he may lose sight of another rule of equity of equal force, namely: That the corpus of an estate should not be unduly increased at the expense of the life tenant. The trustee is in the position of the mariner who must steer his course between the rocks of Scylla on the one hand and the whirlpools of Charybdis on the other.

SPECIFIC PROBLEMS

It is our purpose in this paper to call attention to a few of the conspicuous problems which confront the trustee in making a division of receipts and charges between the life beneficiary and the remainderman. The problem may arise in the execution of trusts wherein the intention of the testator or settlor is not manifested, or it may have its origin in certain variations and changes in the nature of the trustees which the creator of the trust

could not have foreseen or provided for. The differentiation of capital and income may arise in a variety of ways when no specific instructions are provided in the instrument creating the trust. The trustee may be called upon to decide such questions of accounting with respect to dividends on stock, oil and gas royalties, premiums and discounts on bonds, improvements on property, taxes and insurance; in fact, such questions may involve almost every conceivable form of trust property. With respect to many of these situations, more or less definite rules of conduct have been provided by the courts. In other cases, the trustee may not have the benefit of any judicial determination if the specific problem has not been presented to the courts, and he must predicate his conduct upon some custom or course of business accepted as the most practical or the most equitable distribution in order to preserve the interests of all concerned. Sometimes the particular question has been the subject of considerable litigation in different jurisdictions, and there have resulted a number of rules which cannot be reconciled. If the matter has been passed upon by the courts of his jurisdiction, the trustee must, of course, conduct himself in accordance with such decisions. If, however, the courts of his jurisdiction have had no occasion to decide the question and no precedent has been established, the fiduciary may use his own best judgment in adopting the rule of another jurisdiction or the modification of some rule. We shall have occasion herein to offer illustrations of each of these conditions, pointing out the disadvantages to the trustee, as well as to the beneficiaries, which are the result of the confusion among the cases. In our

discussion we refer to rules which prevail in the absence of contrary provisions in the statutes or in the instrument creating the trust. Any such provision is, of course, paramount, and further discussion would be superfluous.

DIVIDENDS

One of the most conspicuous illustrations of the trustee's dilemma in apportioning receipts between capital and income is encountered in the handling of dividends from corporate stocks which may form the whole or a part of the trust res. Usually the ordinary current dividends upon stock held in trusts are credited to the person entitled to the income, if such dividends were declared during the continuance of the life interest, without any apportionment based upon the time of earnings. (Note 1) No substantial injustice is done to the remainderman, although the dividends are not apportioned between him and the life tenant, relative to the moment of the commencement of the life estate, since the dividends are usually small and paid periodically. Moreover, the matter will probably be equalized by the payment to the remainderman of dividends accruing but not declared before the termination of the life tenancy.

A different problem exists, however, where the dividend or distribution is an extraordinary cash or stock dividend as distinguished from the ordinary current dividends declared periodically. Here, as always, the intention of the creator of the trust will govern, if any such intention can be found. Usually the settlor has not provided for such contingency, but has simply used the words "divi-

dividends," "profits," "earnings," or similar phrases. The courts have uniformly held that such words are no more helpful in solving the problem than the single word "income." In their efforts to adjust matters in an equitable and convenient manner, they have developed several rules, which we shall discuss, with their distinguishing features. There are in the main three rules governing the distribution of extraordinary cash and stock dividends, and these are designated as the Massachusetts, the Pennsylvania and the Kentucky rule. The variations in the different rules, even in a single jurisdiction, are so many and go so far afield that they practically constitute cross currents of authority. We shall attempt, however, to present the major points of contrast and comparison and the general practical results of the rules as they appear, without the qualifications and variations which have been imposed by some of the later courts.

THE MASSACHUSETTS RULE

Originally, at common law, all unusual or extraordinary dividends, whether cash or stock, were held accretions to capital, and the life tenant received only the interest thereon. (Note 2) Obviously such a distribution was unjust as to the extraordinary cash dividends based upon earnings accruing after the creation of the trust. The rule was then modified to give unusual cash dividends to the life tenant if paid out of profits. This later English rule corresponds to the rule in the United States commonly known as the Massachusetts rule. This rule was early enunciated by the Supreme Court of Massachusetts in the case of *Minot vs Paine* (Note 3):

"A simple rule is to regard cash dividends, however large, as income, and stock dividends, however large, as capital."

The distinguishing features of this rule are that it awards to capital the entire extraordinary dividends from earnings if the dividends are essentially stock dividends, and to the income if they are essentially cash dividends, without apportioning the benefit with respect to the time covered by the accumulation, whether entirely during the life tenancy or not. Thus the rule turns upon the form of the dividend, whether cash or stock, and refuses to complicate the simplicity of its application by looking to the time, to determine whether all or part of the earnings accrued before the event which marked the beginning of the life interest. Under this rule, therefore, corporate officers, in declaring the nature of a particular dividend—that is, whether it shall be cash or stock—actually determine who shall be entitled to the dividends. The rule has been criticized for this reason by some writers, who maintain that it could not have been the settlor's desire or intention to make the rights of the life tenant or remainderman dependent upon the action of corporate officers in arbitrarily determining the nature of dividends declared by the corporation. Further criticisms have been made of this rule because it does not provide for the apportionment of earnings based on the time the life tenancy existed. It is also argued that to give all stock dividends to the remainderman is to enrich him unduly at the expense of the life tenant. To most of these arguments the courts which adhere to the Massachusetts rule answer, as did the court in the *Minot* case: "A trustee

needs some plain principle to guide him"; and this rule has the virtues of simplicity and certainty. Furthermore, it is said that the apparent injustice will probably be equalized as far as the matter of apportionment is concerned by the payment to the remainderman of dividends which accrued during the life tenancy but which were not declared until after its termination. The arbitrary distribution of stock dividends to the remainderman has been defended on the following reasoning: All earnings belong to the corporation, and the owner of the income has no claim until a dividend has been actually declared. The remainderman, while he acquires ownership of more shares, adds nothing to his proportionate ownership of the assets of the corporation. His holding after the new issue bears precisely the same ratio to the total number of outstanding shares of the corporation as did his previous holding to the previous total. To allot stock dividends to the life tenant would destroy this ratio, which becomes extremely important in voting the stock and in the distribution of assets upon liquidation.

SIMPLICITY OF APPLICATION OF THE MASSACHUSETTS RULE

We repeat that the main virtue of this rule is its simplicity of application. That it sometimes works injustice is not denied by the courts accepting the rule, and the later tendency has been to give the rule a liberal construction. That these courts have shifted their position regarding the mere form of a dividend as a criterion is manifested by the cases where stock dividends in another corporation are considered income if pur-

chased from accumulated surplus earnings. (Note 4) The Massachusetts rule has been followed in Massachusetts, Georgia, Rhode Island, Illinois, West Virginia, Maine, Connecticut, and in the Supreme Court of the United States. (Note 5) The State of New York appears to have had considerable confusion in its cases, some of which seem to adopt the Massachusetts rule, while others lean toward the Kentucky and Pennsylvania rules. (Note 6) In 1926, however, the personal property law of the State of New York was amended with respect to stock dividends, and the Massachusetts rule was adopted. Connecticut had adopted the Massachusetts rule by statute as early as 1902. (Note 7)

THE PENNSYLVANIA RULE

The Massachusetts rule was early repudiated by the Pennsylvania court, which refused to ignore the injustice arising from the failure to apportion earnings between life tenant and remainderman relative to the time of the commencement of the life estate. The Pennsylvania rule, as it has been developed, may be stated as follows: If the entire dividend, whether in cash or stock, was earned before the commencement of the life interest, it must be awarded to the remainderman; if it was earned after the commencement and during the continuance of the life interest, it must be awarded entirely to the life tenant; if the fund was accumulated partly before and partly after the commencement of the life estate, the dividend, whether in stock or cash, must be apportioned between the life tenant and the remainderman, according to their respective periods of time. It

is the latter clause of the rule which distinguishes it as the rule of apportionment. This rule, it will be observed, refuses to make the character of dividend—that is, whether cash or stock—the criterion of the rights of the parties. On the other hand, the courts adhering to this rule maintain that the source of the dividend is the true test. The Pennsylvania rule differs from the Massachusetts rule in two respects: first, under the Pennsylvania rule, stock dividends, as well as cash dividends, declared out of the earnings, may, under certain circumstances, be awarded to the life tenant rather than to the remainderman; second, under the same rule, an apportionment of dividends, whether stock or cash, will be made between the life tenant and the remainderman where the earnings were accumulated entirely before, or partly before, or partly after the commencement of the life interest.

The Pennsylvania case, *Earp's Appeal* (Note 8), which established this rule in 1857, is illustrative of the practical results of the rule. There the executors of an estate were directed to distribute rents, income, and interest of a residuary estate among certain legatees during their respective lives. Part of the residuary estate consisted of stock in a manufacturing corporation upon which large surplus earnings over and above current dividends had accumulated at the time of the testator's death, and continued to accumulate for several years thereafter. During the continuance of the life estate, the corporation declared a stock dividend based upon this surplus fund. The Pennsylvania Supreme Court held that the dividend should be apportioned between life tenant and remainderman—that is, the life

tenant to receive all dividends from earnings which accrued after the commencement of the life interest, while the remainderman should receive dividends from earnings which accrued prior to that time. Under the Pennsylvania rule, the same results would have been reached had the dividends been in cash rather than in stock. Under the Massachusetts rule, the stock dividends would, of course, have been given in their entirety to the remainderman.

The results in the case just discussed indicate that the Pennsylvania rule more nearly approaches justice between the parties than does the Massachusetts rule. Perhaps this is especially true as to stock dividends. When the testator or settlor provides that a certain beneficiary shall have the income or profits from the corpus of the estate, it is doubtless his intention to endow that person with all the earnings accumulated with respect to stock which may form part of the corpus. It would seem that to allot stock dividends declared from earnings to the remainderman is to violate the very probable intention of the testator. The Pennsylvania rule is not, however, without its difficulties, and the increasing complexity of corporate structures makes the rule more and more troublesome in its application. The trustee encounters difficulty first, in applying this rule, because he must determine whether dividends are declared from earnings. In this connection "earnings" means any payment which shall not impair the book value of the stock as of the date of the life interest. The rule places the burden in the first instance upon the trustee or other fiduciary (later upon the courts) of determining, when dividends are from earnings, whether the

value of the stock is impaired by the declaration of the dividend and what portion of the earnings accrued in certain periods. It is usually not difficult to ascertain whether a dividend is declared from actual earnings. It is much more difficult to determine the correct apportionment of the earnings over the periods before and after the commencement of the life interest. An even more troublesome problem arises when one attempts to determine whether the book or intrinsic value of the stock is unimpaired by the dividend. The cases do not seem to be altogether clear as to whether the apportionment is made on the basis of the ratio which the amount added to the surplus after the death of the testator bears to the entire surplus at the time the dividend was declared, or whether it is an apportionment which will simply compensate corpus for the loss in consequence of the dividend, whether stock or cash, in the book or intrinsic value of the original shares as of the date of the commencement of the life interest. In most cases it is probable that the results would be the same whichever basis were used, but the difficulties and complexities which may attend the application of the Pennsylvania rule are apparent. It is becoming increasingly difficult for our economists and lawyers to arrive at any satisfactory method of ascertaining value. The burdens which the rule of apportionment imposes upon the fiduciary will not be simplified, but, in fact, will become more complicated as our commercial and corporate institutions adopt more and more ingenious methods of handling corporate affairs. The justice and equity, which the Pennsylvania rule of apportionment seeks to preserve, lose some of their

persuasive force when we are confronted with the necessity of applying them to a highly complicated corporate situation. However, the courts have escaped some of the difficulties by declaring that an extraordinary corporate dividend, whether cash or stock, is presumptively payable to the party entitled to the income at the time the dividend was declared, but this presumption must yield to the proof of the fact that by such dividend the corporate assets are reduced below their value at the time the trust began. (Note 9) We fail to see how the trustee is aided by any such presumption. He cannot rely upon such a rule of evidence when it is his plain duty to observe the interests of both the life beneficiary and the remainderman; to permit him to indulge in such a presumption is to sanction a preference for the life tenant to the detriment of the remainderman.

In spite of the many criticisms directed toward the difficulty of applying the Pennsylvania rule, this rule has been adopted in many of the later decisions in the United States, and is generally considered the weight of authority. Among states applying this rule are Pennsylvania, Delaware, California, Maryland, New Hampshire, New Jersey, Tennessee, Vermont, and Wisconsin. The States of Maryland and Rhode Island have not been altogether consistent in adhering to either the Pennsylvania or the Massachusetts rule. (Note 10)

THE KENTUCKY RULE

Aside from the Massachusetts and Pennsylvania rules another rule, designated as the Kentucky rule, has been accepted by some courts, nota-

bly, Kentucky. Delaware has shown a tendency to favor the Kentucky rule, and as late as 1927 a Delaware Chancery decision appears to reject the apportionment rule. (Note 11) The Kentucky rule is simply that extraordinary dividends, declared during the life interest, which represent earnings, past or current, as distinguished from capital, are awarded in their entirety to income, without regard to whether the dividends are essentially stock or cash, or whether they represent earnings that have accumulated, wholly or partly, before or after the commencement of the life interest. The Kentucky rule, therefore, depends upon the time of the declaration of the dividends as determinative of the rights of the parties. It is comparable to the Massachusetts rule in the simplicity of its operation, and it escapes the objectionable features of the Pennsylvania rule; namely: An investigation of the business of the corporation and a determination of questions by the trustee or the court, often upon insufficient evidence.

The Kentucky rule often coincides with the Massachusetts or the Pennsylvania rule, but it has never been generally accepted since most of the courts feel that it is much too arbitrary to be considered equitable.

In completing our discussion of the apportionment of extraordinary dividends, we believe it is appropriate to present a brief summary of the results of the three rules.

RESULTS OF EACH OF THE THREE RULES

Let us first assume that we have an extraordinary cash dividend declared from earnings. Our question is how such dividend will be apportioned un-

der the three rules which we have discussed.

1. If the dividend was declared during the life estate from earnings which accumulated during such life interest, the entire amount goes to income under all the rules.

2. If the dividend was declared during the life interest, and was earned entirely before the commencement of the said life interest, it goes to the income under the Massachusetts and Kentucky rules, and to capital under the Pennsylvania rule.

3. If the dividend was declared during the life interest and was earned partly before and partly after the commencement of such interest, it goes to income under the Massachusetts and Kentucky rules, but under the Pennsylvania rule it is apportioned between capital and income.

Now, let us assume that the dividend was a stock dividend.

1. If the dividend declared during the life interest was earned wholly during the continuance of such interest, it goes in its entirety to capital under the Massachusetts rule, and to income under the Kentucky and Pennsylvania rules.

2. If the stock dividend declared during the life estate was earned wholly before the commencement of the life interest, it goes in its entirety to capital under the Massachusetts and Pennsylvania rules, and to income under the Kentucky rule.

3. If the dividend declared during the life interest was earned partly before and partly after the commencement of the life interest, it goes in its entirety to capital under the Massachusetts rule and to income under the Kentucky rule, and, under the Pennsylvania rule, it is apportioned between the life tenant and the remainderman.

We have already stated that stock dividends in another corporation are

awarded to income under the Massachusetts rule. In those states following the Pennsylvania rule, dividends payable in the stock of another corporation, assuming that they represent earnings in capital assets of the declaring corporation, should go to the corpus or to the income to be apportioned according to the period represented by the accumulation of earnings. Thus the Supreme Court of New Jersey, which follows the Pennsylvania rule, in a recent case, observed that dividends payable in the stock of another corporation should be treated in the same manner as dividends payable in the stock of the company declaring them. (Note 12) It would seem that under the Kentucky rule such dividends would inevitably go to income.

RIGHTS AND OPTIONS

Where the stockholders of a corporation are given the rights to subscribe for new shares of stock at par or some amount below par, these stock rights are awarded to corpus and not to income (Note 13), and this has been held true even in those jurisdictions, such as Kentucky and Pennsylvania, which give to income stock dividends based on earnings, because these rights are not dividends in any sense, although they may be due to the existence of undivided earnings. (Note 14)

The Pennsylvania courts have held that where rights are given to stockholders to subscribe for shares in another company, so that there is no resulting decrease in the value of the shares held in trust, the rights should be treated as a product or earnings of the shares and should be given to income. (Note 15)

With respect to options whereby the stockholder has the privilege of taking a dividend either in cash or stock, courts which follow the Massachusetts rule in regard to stock dividends have held that the dividend should be treated as a cash dividend to the extent of its par value, and should go to income, even though it is actually taken in the form of new stock. Thus the transaction is treated as a cash dividend and a simultaneous sale by the company of new stock at par. (Note 16) It would seem that if the new stock is worth more than par, the difference, which represents the value of the right to subscribe for new stock at par, will belong to principal. (Note 17)

LIQUIDATION DIVIDENDS

However the courts may differ as to the division of extraordinary dividends, they are agreed that a dividend which actually represents capital as distinguished from earnings, or which represents assets or liquidation, is to be awarded to capital; else there would be an actual destruction of the corpus of the estate.

AMORTIZING PREMIUMS AND ACCUMULATING DISCOUNTS

We shall turn now to a consideration of the rules of accounting to be observed by the trustee in the purchase of bonds for the trust estate. The fiduciary, under modern commercial conditions, is often required to invest the trust funds in securities which are selling at a premium or at a discount. The question inevitably arises as to whether the loss or gain should fall upon the life tenant or the remainderman. In the case of

bonds purchased at a premium, the almost universally accepted rule is to allow the trustee to amortize the premium; that is, put a periodical charge upon income so that at the maturity of the bonds the amount charged to principal will represent only the face value of the security. The advisability of amortizing the premium, rather than charging the whole sum at once to income, is apparent. If the trustee were to charge the entire premium to income immediately, the life tenant would be deprived of a considerable amount of income in the present that should not be deductible for years to come. Furthermore, if a life tenancy should terminate before the maturity of the bonds, the remainderman would have been unduly enriched at the expense of the life tenant. A few cases, particularly in Kentucky and Pennsylvania, have refused to amortize on the ground that the premiums are not paid to secure greater income, but usually represent safety and permanency of investment, and are, therefore, for the benefit of the remainderman rather than the life tenant. (Note 18) In most jurisdictions, however, the general rule of amortization prevails. (Note 19) It would seem that, in order to approximate justice between the life tenant and the remainderman, discounts on bonds should be credited to the life tenant if we debit the premium to him. In fact, the reasoning of the amortization case has been adopted by many writers, who have maintained that the converse of the proposition should be true; that is, that discounts should be accumulated for the benefit of the life tenant. The question, strangely enough, was never directly before a court of law until 1926. In that year, the Supreme

Court of California considered the question squarely, and, to the amazement of most writers on the subject, this court refused to allow the life tenant the benefit of such a discount. The decision was all the more unusual, because a few years earlier, in a case involving the same estate, the California court had authorized the deduction from income of premium on bonds. It was manifestly unfair to refuse the life tenant the benefit of the discount, and we believe it is worth while here to outline briefly the history of these cases.

A CASE DECIDED BY THE CALIFORNIA SUPREME COURT IN 1921

The first case, which bears the name of *Estate of Gartenlaub*, was decided by the California Supreme Court in 1921. (Note 20) The decedent, Gartenlaub, devised and bequeathed the greater part of his estate in trust to the Union Trust Company of San Francisco, empowering the trustee to convert the estate into money and invest in certain described bonds. By the terms of the will the trustee was directed to pay to the wife of the testator monthly, during her life, three-fourths of the "entire net income, revenue, and profit of every kind arising from said estate," with remainder over. The wife appealed from an order of the Superior Court of San Francisco, settling the annual account of the trustee, on the ground that the trustee had erroneously deducted certain sums from income and credited to principal. The sums deducted represented sums taken by the trustee from the income to provide a sinking fund to take care of premiums paid on bonds purchased from the trust fund. The court ruled:

"In the absence of a clear direction in the will to the contrary, where investments are made by the trustee, the principal must be maintained intact from loss by payments of premium on securities having only a definite term to run."

It was said that the ostensible return yielded by the bond could not be considered entirely as interest on the face value of the bond, for a sum in excess of that face value had gone into the investment, and that a portion of the nominal interest was, therefore, a repayment of the premium. A few years after this decision, another annual account of the trustee was appealed from by the same life tenant, because the trustee refused to allow her the profits made by the purchase of bonds at a discount. In this case the life tenant asked that, since in the previous case the court had allowed the amortization of premiums for the benefit of the remainderman, justice demanded that it should then allow accumulation of discounts for the benefit of the life tenant. The court refused to adopt this reasoning, and held that the remainderman should again have the benefit. It was said that the amount of the discount remained in the hands of the trustee in the form of uninvested corpus and could not, in the nature of things, be considered a part of the profits or income therefrom. The court apparently misses the point that the trustee will probably invest this discount in more bonds, and the corpus of the estate will, in fact, be enlarged.

The life tenant, furthermore, urged that discount bonds would have a lower rate of interest, but the court denied this in the face of all contrary assertions of both accountants and students of finance. It would seem

to be elementary that both sound theory and equitable considerations would have required the court to recognize the accumulation of discounts as well as the amortization of premiums. Such a rule gives the trustee a definite and practical guide, which is reasonably fair to all parties concerned. Absolute justice would, of course, be impossible if we considered the fluctuations in the price of bonds during the period they are held by the trustee, but the trustee should not take advantage of such fluctuations to speculate in buying and selling the trust securities. Hence the rule contended for would certainly bring about as complete equality as possible under the circumstances. In any case, we think it is very likely that when a similar question with respect to accumulation of discounts is again presented to an appellate court, the decision of the Supreme Court of California will be reversed.

OIL AND GAS ROYALTIES

The distribution of royalties on oil and gas properties is a matter of considerable importance in a number of our states. The trustee is called upon to decide whether or not he will give to the person entitled to the income all the income from royalties which may accrue during the continuance of a given estate. In considering the problems of oil and gas royalties, courts have invariably followed the rules which have been followed with respect to other minerals. All minerals are considered a part of the heritage, and the removal of them diminishes by so much the value of the land; it is a destruction of the corpus of the estate, and, logically, the trustee, or other fiduciary, must account to the

principal or remainderman for such destruction. The general rule appears to be that the life tenant has no authority to exploit oil and gas resources, or to authorize another to do so, unless permission is granted by the person creating the life estate. Such permission may be a formal authorization contained in the instrument creating the estate, or it may be found in the fact that the settlor had opened or authorized the opening of mines before he created the estate, and that he must have intended the life tenant to receive the benefit. Therefore, if the testator or settlor, prior to the creation of the estate, has opened oil and gas wells, or has made a lease which contemplates opening such wells, the entire royalty or income is payable to the person who is entitled to the general income. In such case the remainderman gets no royalties, except those accruing after the termination of the life interest, and it appears to be immaterial that the oil and gas resources may be entirely dissipated by the life tenant. Where the wells were actually opened and in operation when the life tenancy began, there can be no doubt that the testator intended the life tenant to have the entire benefit of the royalties, and the courts so award them. And, as we have pointed out, there are circumstances under which the wells may be opened for the benefit of the life tenant because of some act by the original owner or settlor. These are ordinarily cases where a valid lease has been made but no wells opened prior to the commencement of the life tenancy. In many of the cases the life interest is held without intervention of a trust, but none of the cases has appeared to turn upon any distinction in that

respect. Accordingly, rules with respect to life tenancies generally are applicable to tenancies held under a trust. Thus, where the owner of land, after leasing it for oil and gas, conveyed it to his children, reserving to himself a life interest in it, it was held that he was entitled to the royalties under the lease. (Note 21)

CASES APPEARING TO BE CONTRARY TO GENERAL RULE

There are a number of cases which appear to be contrary to the general rule, but which, in fact, merely carry out the obvious intent of the settlor. Such a case was decided by the Circuit Court of the United States for the Northern District of Ohio in 1893 (Note 22), where the will gave the trustee such general powers of management and control as the testator himself would have were he living. The chief value of the lands in question was in the coal under the surface, but there appeared to be no specific directions for coal leasing. The executor executed a lease on the coal lands, and it was held that the royalties obtained from the coal should be awarded to the income and not to the principal of the estate. To the same effect is a Pennsylvania case (Note 23), where the land was valuable only as coal land, and the executors were given power to collect and give all income of the estate to the testator's wife, and were, furthermore, given power to sell or lease the lands as they thought best. It was held that the power to lease gave them the power to lease for mining purposes, although no mine had ever been opened on them prior to the death of the testator, and that the rental arising from such a lease went

to the life tenant as income. These two cases seem to go to the extreme limit in awarding royalties to the life tenant although the trustee or executor is given only general powers of leasing and control. The explanation is, of course, that the courts, after considering all the facts and circumstances, believed it was the intention of the testator that the life tenant should receive the royalties. In another Pennsylvania case a married woman, joined by her husband, conveyed certain lands to trustees, with power to lease for mining and other purposes. The income from the property was to be paid to the woman, who agreed to support the children of the marriage. The property was used for agricultural purposes and netted only a few hundred dollars each year. After the creation of the trust the trustees leased the coal lands, realizing an income of several thousand dollars each year. It was held that the money received for such leases was income to be paid to the life tenant, because otherwise the education and support of the children could not be accomplished, since the agricultural income was quite insufficient for these purposes. (Note 24) From these cases it would seem that the law may be thus stated (Note 25): If the wells are opened, or a valid lease is made, by the creator of the trust, the life tenant is entitled to the oil and gas royalties. Even if no lease is made by the settlor, the life beneficiary may yet be entitled to the whole of the royalties if the trustee or other fiduciary is given authority to lease for such purposes (or perhaps for any purpose), or is instructed to manage and control the property in the same manner and with the same freedom as if he were

the settlor himself. This is especially true if the payment of the entire royalties to the life tenant is necessary in order to carry out the wishes of the settlor with respect to the education and support of the life beneficiaries. In passing, it is appropriate to remark that once the right of the life tenant to the royalty is established no limit is placed upon the right, and he may keep all such royalties, even though they represent the whole of the oil and gas resources which have been exhausted.

Where no wells have been opened, no leases made, and no authority given the trustee or other fiduciary to make the leases, the life tenant is not entitled to the royalties. He may claim only the interest upon them invested for his benefit. The royalties in such case represent a part of the corpus of the estate, not having been severed therefrom by any act or instruction of a settlor or testator.

INCREASES IN LIVE STOCK AND PERSONAL PROPERTY

There are, of course, innumerable situations in which the trustee has the duty of making a division of charges between the life tenant and the remainderman, and it is obviously impossible for us to discuss all these situations in the space allotted us. We can only refer to some of the major conflicts and to some of the more frequent problems. Some of these problems are fairly well settled, and we mention them only in passing, with occasional reference to any unusual variations. Among the accepted rules in the administration of trusts is that which holds that increases in farming stock and such personal property accrue to the life tenant,

since he is under no duty to make such increases. (Note 26) It is interesting to note in this connection that in some of the southern states the increase in slaves was awarded to the remainderman. With respect to improvements on real estate, it is a well settled rule of property law that all such improvements made by the life tenant will accrue to the remainderman. This observation brings to mind the query, whether the trustee must pay for the repairs of the estate out of the income. The trustee's conduct in this respect should be governed by the general laws which determine the correlative rights of life tenants and remaindermen. Generally it is said that a life tenant is charged with such ordinary repairs as are necessary to keep the property in as good condition as when he received it. (Note 27) It does not follow, however, that income should be charged with permanent improvements which will accrue to the benefit of the remainderman or to permanent alterations upon a trust property. (Note 28) The trustee must pay for such improvements or changes from the capital, provided, of course, he has authority to use capital for such purposes. In this connection, it has been held that changing a building from a dwelling house to a store or hotel falls in the category of permanent improvements changeable to corpus, while repairing, replumbing and such repairs are chargeable to income. (Note 29) Obviously it may be difficult at times to determine what are permanent improvements as contrasted with ordinary repairs. It is a question of fact, depending upon the circumstances of each individual case, and upon the language of the settlor, and

it would be idle for us to attempt at this time to make any enumeration which would be helpful to the trustee in determining the nature of the particular transaction.

INSURANCE

The trustee may be called upon to decide who shall pay for insurance upon property which may constitute the whole or a part of the trust res. We are not here concerned with the insurable interests or rights of the parties, but rather with their duties. Ordinary prudence and business foresight will prompt the trustee to effect insurance upon the property, and, in fact, it is his duty to do so. He may be uncertain, however, whether he is justified in charging the premiums entirely to one or to the other, or whether he should apportion them between the parties. It has been said that ordinarily a trustee, who holds the property for life tenant and remainderman, having the duty to insure may charge the premiums of such insurance to the income as one of the ordinary expenses of management and upkeep of the property. (Note 30) There is, however, some obscurity in the cases, as to whether the entire cost is chargeable to income, although the insurance covers the interest of both life tenant and remainderman. Usually the testator or settlor has indicated no intention, and, theoretically, it would seem that the remainderman should bear his portion of the expense. It is believed, however, that the courts usually go on the theory that it is more in accord with common experience to suppose that the testator contemplated that the cost of insurance would, like taxes and interest on incumbrances, be a

charge necessary for the maintenance of the estate, and, therefore, chargeable to income. It would certainly seem that if the insurance is necessary to keep a mortgage alive, income must pay it. The Supreme Court of Washington (Note 31) in 1914 held that the true solution of the problem was to be found in the answer to the question,

"To whom will the benefit inure—if the insurance benefits solely the life tenant, then the tenant must pay the premium, if to the remainderman, then he must pay it; if to both the tenant and remainderman, it must be apportioned between them."

The effect of such a test was somewhat qualified by the further remark that since it is the policy of the law to keep an estate intact for the remainderman, and since the benefit derived from the insurance, under the doctrine of property, would inure solely to the benefit of the life tenant, the life expectancy of the life tenant being the same as that during which it was estimated the buildings would last, it was adjudged that the life tenant should bear the burden. The courts of New Jersey and Pennsylvania seem to favor an apportionment between the life tenant and the remainderman. (Note 32) This is perhaps a fair rule, but it places a burden upon the trustee of deciding when the insurance inures to the benefit of the remainderman. The simpler procedure seems to be to charge it to income as one of the ordinary expenses of upkeep and management.

TAXES

The duty of the life tenant to pay taxes on trust property is prescribed

by statute in some jurisdictions. Even in the absence of such a statute, the ordinary taxes are charges on the life estate to be paid out of income, and it has been so held, although the estate consisted of some unimproved and unproductive lands. (Note 33) Ordinarily the courts do not favor an apportionment where the life tenant dies before the end of the year for which taxes are assessed. Pennsylvania, however, appears to favor such an apportionment.

INHERITANCE TAXES

Inheritance taxes on the interest of the life tenant are payable out of the income, while such taxes on the interest of the remainderman are payable out of corpus. This is in harmony with the theory that inheritance taxes are taxes upon the privilege of succession rather than upon fund inherited. Where the inheritance tax is in the nature of a transfer tax to be paid immediately upon the testator's death, the New Jersey courts have held that the corpus is liable for the tax on the life estate. The court reasons that the legislature intended that this source of state income should be definite and certain, and that it should not be delayed or defeated by any contingency. As a matter of fact, the act provides that this tax must be paid before the executor delivers any property to the life tenant or other beneficiary. With respect to income taxes, state statutes usually provide for the taxation of the income received by the beneficiary from a trust estate. Naturally this tax should be paid from income. There are no decisions by the courts which relate to the payment of income taxes on trust estates except perhaps the case

of *In re King*, decided by a lower court in New York in 1927. (Note 34) This case simply holds that income taxes paid on income from an estate are properly charged against principal so far as they are imposed upon income or profits made by the estate not distributed nor distributable to the life tenant. It would follow inevitably from this decision that the life tenant must pay income taxes where the profits or income are distributed or distributable to him.

BROKERAGE

Some courts hold that brokerage charges which are incurred in the investments or reinvestments made by the trustee are to be charged to capital or income, according to the reason for which the investment was made. For instance, if the purchase is in accordance with the provisions of the will or trust instrument for the purpose of converting the property into the form authorized by the said instrument, the expenses of making the change should be paid from the corpus. On the other hand, if the sale is merely for the purpose of changing the investment, it is an ordinary expense of management and is chargeable to income. It has been suggested that the usual practice among trustees is to pay brokerage charges from capital. In Massachusetts it has been held that such charges should be payable from income, and this rule was applied to a large commission payable upon the sale of real estate. (Note 35) Since that decision the legislature of Massachusetts has provided by statute that trustees' and brokers' commissions, and other expenses properly incurred and paid to the trustee for and in con-

nection with the sale, exchange, or purchase of property, shall be charged to principal. This obviates any necessity for distinguishing sales for the purpose of making authorized investments and mere changes in investments.

UNIFORM PRINCIPAL AND INCOME ACT

We have tried to call attention to some of the major accounting problems. It is apparent that there is more or less confusion in the law, which is applicable to these problems. This confusion is due in part to differences in economic convictions of the courts. In some cases it was believed that convenience of application in the test which the court was to provide should be paramount to considerations of equality and justice which are based upon rather refined accounting principles. No doubt the trustee prefers the convenience of application to refinements of accounting. In any case, there is need for an ascertained rule upon which a uniform trust practice can be based. Neither the trustee nor the judge should be called upon to lay down an arbitrary rule or else resort to principles of political economy and accounting, which few trustees and judges are competent to deal with on a large scale. The proposed Uniform Principal and Income Act, if adopted by the state legislatures, would obviate much of the uncertainty and confusion now existing in this branch of trust administration. (Note 36) The committee in charge of this act admit that it is not their purpose to cover the entire field of the trustee's general powers and duties; their only aim is to produce an act which will

provide a certain rule for the ascertainment of rights between the life tenant and the remainderman. The committee expressed their desire to provide an act which will appeal to trust officers as workable, and to attain this end they have found it advisable, or, rather, necessary to adopt arbitrary rules with respect to many of the problems.

PROBLEMS SOLVED BY THIS ACT

That you may understand the approach of the committee, as well as the actual provisions of the act, we think it is appropriate here to discuss the major problems which it is intended to solve. In the present form the act is entitled, "Uniform Principal and Income Act—An Act concerning the Ascertainment of Principal and Income and the Apportionment of Receipts and Expenses among Tenants and Remaindemen, and to Make Uniform the Law with Reference Thereto." The first section of this act contains definitions of such terms as "principal," "income," "tenant," "remainderman," and "trustee." Section 2 provides that the act shall govern the ascertainment and apportionment of income, principal, and expenses unless the creator of the trust has directed an ascertainment or apportionment in a manner inconsistent with the act. This would seem to validate a direction in the trust instrument that might otherwise be considered an illegal accumulation. Sections 3 and 4 relate generally to income and principal and their disposition. Section 5 deals with the very important subject of corporate dividends and their rights. The committee considered the difficulties of computation under the Pennsylvania

rule and the troublesome questions which inevitably arise when the trustee or the court is faced with the necessity of valuing the assets or apportioning the earnings of the corporation. For this reason it was decided to adopt the Massachusetts rule in the Uniform Act. The provisions relative to the distribution of corporate dividends and rights are as follows:

SECTION 5

CORPORATE DIVIDENDS AND SHARE RIGHTS

"(1) All dividends accruing on shares of a corporation which form a part of the principal and payable in the shares of such corporation shall be deemed principal. Subject to the provisions of paragraph 3 of this section, all dividends payable otherwise than in the shares of the corporation itself, including ordinary and extraordinary dividends, shall be deemed income. Where the trustee shall have the option of receiving a dividend either in cash or in the shares of the declaring corporation, it shall be considered a cash dividend and deemed income, irrespective of the choice made by the trustee.

"(2) All rights to subscribe to the shares or other securities or obligations of a corporation accruing on account of the ownership of shares in such corporation, and the proceeds of any sale of such rights, shall be deemed principal; all such rights accruing on account of the ownership of shares in another corporation and the proceeds of any sale of such rights shall be deemed income.

"(3) Amounts paid upon corporate shares upon liquidation of the assets of the corporation as a return of the original investment and such part of dividends as is designated by the corporation as a return of capital or distribution of assets shall be deemed principal."

BOND PREMIUMS AND DISCOUNTS

The question of premiums and discounts on bonds is next considered in the act. The Committee gave a great deal of time and attention to this feature of trust accounting. Questionnaires were sent out to leading trust companies, and the advantages and disadvantages of amortization of premiums and accumulations of discounts were discussed with particular reference to the purposes of trust companies in this respect. The Committee weighed all the evidence adduced by these questionnaires, and decided, from the standpoint of fairness and justice in all cases, that the provision for amortization seemed undesirable. With respect to accumulations of discounts, the answers to the questionnaires revealed that the trust companies were almost unanimously against such accumulations. It was the judgment of the Committee that if they rejected the amortization of premiums they should likewise reject the accumulation of discounts. For this reason Section 6 of the Act provides for neither amortization of premiums nor accumulation of discounts. On the other hand, it provides that where the principal consists of bonds or such obligations, they shall be deemed principal at their cost price, regardless of their par or maturity value, and that upon their maturity or sale any loss or gain realized shall fall upon the principal.

Sections 7 and 8 of the proposed act provide for the apportionment of income consisting of rents, annuities and other periodic receipts, upon the termination of the life estate at a time other than the date when such payments are made.

Further provisions are made in

Sections 9 and 10 for property designed for sale at retail and for property subject to depletion, such as leaseholds, oil and gas wells, and so forth. With respect to property subject to depletion, the act provides that the trustee shall provide a fund for amortization which shall be sufficient to pay any charges which may be expected in connection with the property, such as the sale of buildings erected on property under an agreement that the lessors shall purchase the same at some future time. It is further provided that the income from such properties shall be the royalties or receipts from rentals or the sale of the products for the payment of necessary expenses and the amount necessary for amortization. The following section relates to lands containing quarries, timber and other natural products, and provides that the trustee, the life tenant, or remainderman may petition the court to have such resources developed. The proceeds of the sale or lease of such lands shall form a part of the principal and be invested to produce income. It is expressly stated that nothing in this section shall be construed to abrogate any right which a tenant may otherwise have had to work mines or quarries, to cut or consume timber, or otherwise exploit the natural resources of such lands. These two sections taken together apparently do not change the law with respect to the rights of the life tenant to receive royalties on oil and gas properties which are already opened or authorized to be opened by the creator of the trust, nor do they enlarge his rights in such properties if the creator of the trust has not made or authorized leases for the exploitation of resources.

Section 12 relates to unproductive estates. It is there provided that the sale price of such property shall be divided as follows: All that portion of the net sale price which, had it been placed at interest at the average rate of income produced by other parts of the principal, for the period during which the sale has been delayed, should have produced the net sale price, shall be deemed principal; and the remaining portion thereof shall be deemed income for the benefit of the life tenant.

The expenses incurred in connection with the trust estate or with its administration and management, including regular taxes, water rates, insurance premiums, interest on mortgages, ordinary repairs, trustee and court fees, are to be paid out of the income. All extraordinary expenses for permanent improvements, including special benefit or improvement taxes or assessments, shall be paid out of principal. Any tax upon profit or gain, defined as principal under the terms of the act, shall be paid out of principal, notwithstanding said tax may be denominated a tax upon income by the taxing authority. It is understood that this section refers only to capital gains on principal and does not relate to ordinary income from principal.

ADVANTAGES OF THESE PROVISIONS

The simplicity of these provisions is unquestioned; that they may work an occasional hardship will not be denied, but the advantages of a certain guide surely outweigh the incidental hardships. It should be stated in passing that the act has not yet been accepted by the Conference of

Commissioners on Uniform State Laws. Before it is accepted by this conference, it is expected that some changes may be made in the provisions which we have just discussed. Furthermore, it should be remembered that if this act is adopted by the state legislatures it can only apply prospectively—that is, to wills drafted before the act but not made effective until later, and to trust instruments executed after the adoption of the act. It will, therefore, furnish not only rules of conduct for the trustee in the administration of trust estates, but will also give the settlor or testator definite information for his guidance in distributing his estate.

NOTES

1. Perry on Trusts (1929 Ed. Sec. 544);
Earp's Appeal, 1857, 28 Pa. 368;
McKeown's Estate, 1919, 263 Pa. 78; 106 Atl. 189.
2. See the illuminating articles in 24 A. L. R. 1; 42 Id 450; 50 Id 376; for a general discussion of the apportionment of stock dividends.
3. Minot vs Paine, 99 Mass. 108.
4. Old Colony Trust Company vs Jameson, 256 Mass. 179; 152 N. E. 52;
Union & New Haven Trust Company vs Taintor, 1912, 85 Conn. 452; 83 Atl. 697;
Mercer vs Buchanan, 132 Fed. 501.
5. Minot vs Paine, Supra, Note 3;
Gray vs Hemenway, 1910, 206 Mass. 126; 92 N. E. 31;
Smith vs Cotting, 1918, 231 Mass. 42; 120 N. E. 177;
Old Colony Trust Company vs Jameson, Supra, Note 4;
Jackson vs Maddox, 1911, 136 Ga. 31; 70 S. E. 865;
Brown's Petition, 1884, 14 R. I. 371;
Newport Trust Co. vs Van Rensselaer, 1911, 32 R. I. 231; 78

- Atl. 1009; but see *Rhode Island Hospital Trust Company vs Peckham*, 1919, 42 R. I. 365; 107 Atl. 209;
- DeKoven vs Alsop*, 1903, 205 Ill. 309; 68 N. E. 930;
- Billings vs Warren*, 1905, 216 Ill. 281; 74 N. E. 1050;
- Security Trust Company vs Ramnellsberg*, 1918, 82 W. Va. 701, 97 S. E. 122;
- Richardson vs Richardson*, 1883, 75 Me. 570;
- Harris vs Moses*, 1918, 117 Me. 391;
- Mills vs. Britton*, 1894, 64 Conn. 4; 29 Atl. 543;
- Union & New Haven Trust Company vs Taintor*, Supra, Note 4.
- Bishop vs. Bishop*, 1909, 81 Conn. 509; 71 Atl. 583;
- Humphrey vs Long*, 1915, 169 N. Car. 601; 86 S. E. 526;
- Gibbons vs Mahon*, 1890, 136 U. S. 549; 10 S. C. 1057.
6. *Re Kernochan*, 1887, 104 N. Y. 618; 11 N. E. 149;
- Lowry vs Farmers Loan & Trust Company*, 1902, 172 N. Y. 137; 64 N. E. 796;
- Richards vs. Richards*, 1908, 123 A. D. 117; 108 N. Y. Supp. 298; for later developments in New York, see A. L. R. Notes, Supra, Note 2.
7. See Section 5041 of the General Statutes of Connecticut, 1918; Laws of New York, 1926, Ch. 843;
- See also Georgia Code, 1926, Sec. 3667.
8. *Earp's Appeal*, Supra, Note 1.
9. *McKeown's Estate*, Supra, Note 1.
10. *Rhode Island Hospital Trust Company vs Peckham*, Supra, Note 5;
- Quinn vs Safe Deposit Company*, 1901, 93 Md. 285; 48 Atl. 835.
- The following cases follow the Pennsylvania rule with respect to apportionment:
- Re Duffil*, 1919, 180 Cal. 748; 183 Pac. 337;
- Thomas vs Gregg*, 1894, 78 Md. 545; 28 Atl. 565;
- Miller vs Safe Deposit Company*, 1916, 127 Md. 610; 96 Atl. 766;
- Goodwin vs McGaughey*, 1909, 108 Minn. 248; 122 N. W. 6;
- Walker vs Walker*, 1895, 68 N. H. 407; 39 Atl. 432;
- Holbrook vs Holbrook*, 1907, 74 N. H. 201; 66 Atl. 124;
- Van Doren vs. Olden*, 1868, 19 N. J. Eq. 176;
- Ballantine vs Young*, 1911, 79 N. J. Eq. 70; 81 Atl. 119;
- Brown vs Brown*, 1907, 72 N. J. Eq. 667; 65 Atl. 739;
- Earp's Appeal*, Supra, Note 1.
- McKeown's Estate*, Supra, Note 1.
- Harkness' Estate*, 1925, 283 Pa. 464; 129 Atl. 458;
- Mallory's Estate*, 1926, 285 Pa. 186; 131 Atl. 714;
- Wallace vs Wallace*, 1911, 90 S. Car. 61; 72 S. E. 553;
- Soehnlein vs Soehnlein*, 1911, 146 Wis. 330; 131 N. W. 739;
- Miller vs Payne*, 1912, 150 Wis. 354; 136 Atl. 811;
- Pritchitt vs Nashville Trust Company*, 1896, 96 Tenn. 472; 30 S. W. 1064;
- Re Heaton*, 1915, 89 Vt. 550; 96 Atl. 21.
- See also *Beattie vs Gedney*, 1926, N. J. Eq.; 132 Atl. 652, which adhered to the Pennsylvania rule and said that the other rules were adopted arbitrarily for the convenience of the trustees in the discharge of their duties and the courts who instruct them in their duties.
11. *Goff vs. Evans*, 1927, 217 Ky. 664; 290 S. W. 490;
- DuPont vs Peyton*, 1927, Del. Chancery; 136 Atl. 149.
12. *Bourne vs Bourne*, 1925, 240 N. Y. 172; 148 N. E. 160;
- Kochler vs Kochler*, 1926, 99 N. J. Eq. 141; 132 Atl. 751.
13. *DeKoven vs Alsop*, Supra, Note 5;
- Hyde vs Holmes*, 1908, 198 Mass. 287; 84 N. E. 318;
- Brinley vs Grow*, 1882, 50 Conn. 66.
14. *Hite vs Hite*, 1892, 93 Ky. 257; 20 S. W. 778;

- Eisner's Appeal, 1896, 175 Pa. 143; 34 Atl. 577;
 Moss's Appeal, 1877, 83 Pa. 264.
15. Eisner's Estate, Supra, Note 14.
 16. Hyde vs Holmes, Supra, Note 13.
 17. Hyde vs Holmes, Supra, Note 13.
 Day vs Faulks, 1911, 79 N. J. Eq. 68; 81 Atl. 354.
 18. Hite vs Hite, Supra, Note 14;
 Penn-Gaskell's Estate, 1904, 208 Pa. St. 346; 57 Atl. 715.
 19. Curtis vs Osborn, 1907, 79 Conn. 555; 65 Atl. 968;
 In re Allis' Estate, 1904, 123 Wis. 223; 101 N. W. 365;
 Ballantine vs Young, Supra, Note 10.
 Re Gartenlaub, 1921, 185 Cal. 648; 198 Pac. 209.
 20. Re Gartenlaub, Supra, Note 19.
 Re Gartenlaub, 1926, 198 Cal. 204; 244 Pac. 348;
 See Premiums and Discounts in Trust Accounts, 31 Harvard Law Review, 447, and notes in 4 A. L. R. 2149, and 48 Id. 684.
 21. Koen vs Bartlett, 1895, 41 W. Va. 559; 23 S. E. 664.
 22. Reynolds vs Hanna, 1893, 55 Fed. 783.
 23. Wentz Appeal, 106 Pa. St. 301;
 See also Thornton on Oil and Gas, Sec. 301.
 24. Appeal of Bedford, 1889, 126 Pa. 117; 17 Atl. 538.
 25. Lawley vs Richardson, 1924, 101 Okla.; 223 Pac. 156;
 Andrews vs Andrews, 1903, 31 Ind. App. 189;
 Minner vs Minner, 1919, 84 W. Va. 679; 100 S. E. 509.
- The following cases allowed the life tenant only the interest on the royalties because wells were not opened or authorized prior to commencement of life interest:
- Ohio Oil Company vs Daughtee, 1909, 240 Ill. 361; 88 N. E. 818;
 Eager's Guardian vs Pollard, 1922, 194 Ky. 276; 239 S. W. 39;
 Williamson vs Jones, 1897, 43 W. Va. 562;
- Wilson vs Youst, 1897, 43 W. Va. 826; 28 S. E. 781;
 Meredith vs Meredith, 1921, 193 Ky. 192; 235 S. W. 757;
 Swayne vs Lone Acre Oil Company, 1905, 98 Tex. 597; 86 S. W. 740.
26. See Perry on Trusts, Sec. 547.
 27. Little vs Little, 1894, 161 Mass. 188; 39 N. E. 795;
 Abel vs Brady, 1894, 79 Md. 94, 101; 28 Atl. 817.
 28. Abel vs. Brady, Supra Note 27;
 In re Parr, 1904, 92 N. Y. Supp. 990.
 29. See Perry on Trusts, Sec. 552a.
 30. Bridge vs Bridge, 1888, 146 Mass. 373; 15 N. E. 899;
 Stevens vs Melcher, 1897, 152 N. Y. 551; 46 N. E. 965;
 Richardson vs McCloskey, 1924, Tex. Civ. App.; 261 S. W. 801; reversed, 1925, 276 S. W. 680, where the court refused to class insurance with expenditures for current taxes and repairs.
 31. Stohl vs Schwartz, 1914, 81 Wash. 293; 142 Pac. 651.
 32. These cases are, however, usually governed by statute.
 See Perry on Trusts, Sec. 553.
 33. Martin vs Kimball, 86 N. J. Eq. 10; 96 Atl. 565; Spencer vs Spencer, 219 N. Y. 459; 114 N. E. 849;
 See also Perry on Trusts, Sec. 554;
 A Pennsylvania case favoring apportionment is Crump's Estate, 13 Pa. Co. Ct. 286;
 See also Rhode Island Hospital Trust Company, Supra, Note 5.
 34. In re King's Estate, 1927, 130 Misc. 296; 224 N. Y. Sup. 283.
 With respect to inheritance taxes, See In re Diehl, 1917 (N. J.); 102 Atl. 738, holding that a transfer tax on a life estate is payable from corpus. There the act makes the tax payable immediately upon the testator's death.
 35. See Perry on Trusts, Sec. 554.
 36. For general notes and discussion of this act, see 1928 Handbook of National Conference of

Commissioners on Uniform
State Laws, page 206, et seq.

Discussion

HUGH MCLAIN (Colorado National Bank, Denver): Is there some practical rule by which in case of doubt the trustee might resolve that doubt in favor of either the life tenant or the remainderman?

JUDGE H. L. STANDEVEN (Exchange Trust Company, Tulsa): There is no practical rule. The trustee must act upon his own responsibility. There may be a way of getting into the courts of equity to determine that question, but in order to do so you run against the almost impossible situation of securing service upon the remaindermen, who are, in many cases, still unborn children. It is hardly possible to get into court that way and make a binding decision. So that the responsibility is largely the trustee's; for that reason the trustee must be very careful in making his decision, particularly if he pays anything to the life tenant, because then it would not be recoverable for the benefit of the remaindermen in years to come when the company might be haled into court to account to unborn children when they become of age as to the corpus they paid out.

WILLIAM H. KING (Fort Worth National Bank, Fort Worth, Texas): If my state had not passed upon the question of stock or cash dividends, which rule would you follow?

JUDGE STANDEVEN: According to the research work, the majority of states follow the apportionment plan of Pennsylvania. The trust companies as a whole, and the latter decisions, rather favor the Massachusetts rule. I think it will depend largely

upon what the courts in your state follow. If they follow the procedure of California, it would be wise to follow the line of authorities your state usually adopts. In making my decision that is what I would do. I would find out the general policy of the supreme court of my state. In Oklahoma we usually follow the California and Ohio and New York cases.

LAURENCE COOPER (Harris Trust & Savings Bank, Chicago): I should like to know how many amortize as a practical matter. Secondly, should the trustees apply to the court when in doubt as to what constitutes principal or income? If the trustee makes the decision himself, I can conceive he would have to take the consequences.

JUDGE STANDEVEN: I will state that the general rule of trust companies, I think, is that most of them amortize the premiums. For instance, if a bond is a five per cent bond and is bought on a four-ten basis, it is set up in that way; that is, a great many of them do, although the general tendency is to get away from either amortization or accumulation of discounts. The proposed uniform principal and income act gets away from both of those entirely and does away with both amortization and accumulation of discounts.

MR. COOPER: Supposing, Judge, bonds amortized are called at a premium greater than the original premium paid. How would you handle that premium?

JUDGE STANDEVEN: The increase belongs to corpus. In other words, I think you would be well within your rights to allow the callable feature to the corpus of the estate and adjust the income on the basis of the rated coupon.

Effective Investment Management of Group Funds

By NELSON M. McKERNAN

ASSISTANT SECRETARY OF THE IRVING TRUST COMPANY, NEW YORK, N. Y.

Address before the Denver Departmental Conference

Mr. McKernan, in the course of his discussion of the investment management of trust funds, lists the principal functions of investment management as follows:

1. To establish a sound investment plan suitable to the purposes of the investor
2. To determine what proportion of the fund shall be in equities and what proportion in bonds or other maturing obligations, having in mind current industrial and economic conditions
3. To watch for changes in conditions and to be prepared to modify these proportions in harmony with such changes
4. To study the current conditions of various industries and groups of industries, and to select a diversification of those which, upon reliable data, may be regarded as the most promising
5. To examine the management and financial structure of the leading companies in these industries
6. To watch for changes in the conditions of both industries and individual corporations, and to be prepared to change the investment to accord with sound analysis of the latest available information
7. To retain diversification as the fundamental principle, but to establish reasonable limitation to diversification in order not to dilute the quality of management applied.

DURING the past year or two interest in the management of group investments has greatly increased. This has come about through varying causes, but mainly through the propaganda accompanying formation of new holding, finance, and trading companies. In many of these the management of investments, at least from the investors' standpoint, has seemed to be secondary. Instead, the apparent purpose often was to create securities for sale at a profit. In other cases the desire was to marshal funds to assist in controlling affiliated

or other companies and in some, apparently to gather capital which might, on occasion, assist in absorbing security issues or provide a source of buying and selling orders with the resulting brokerage commissions. Many companies appear to have been formed to give customers of brokerage houses the investment trust type of security which they demanded.

In other directions group funds were created to provide a medium whereby the investment funds of a bank's customers might, with a minimum of effort, benefit from the invest-

ment knowledge of the bank's official family and, in other instances, because of a desire to offset the increasing cost of high-grade investment management of many funds, including those supplied from trusts, through reducing the number of resulting investment problems by applying all management to one composite fund in which each customer or trust would have an undivided interest.

INVESTMENT TRUSTS FOR THE BENEFIT OF THE INVESTOR

However, some investment trusts have been established with the sole object of providing a medium through which the knowledge and judgment of an experienced group of specialists could be made available to the investor and through which investment problems would be studied solely from his viewpoint. For these services the respective managements would receive compensation either in the form of a share in the profits or by way of a fixed management fee.

Limiting consideration to the latter group it appears that such management, to be 100% effective in behalf of the investor, must owe its loyalty solely to the owners of the funds. Therefore, we will agree that there must be no object other than protection of the investor; there must be no divided allegiance such as would exist if there were a conflicting self-interest, such as side profits to be derived from trading with officers, directors, or an affiliated company.

WHAT CONSTITUTES THE EFFECTIVE INVESTMENT MANAGEMENT OF GROUP FUNDS?

Assuming such unbiased manage-

ment, we come to the question of what constitutes the effective investment management of group funds. It is my opinion that the outstanding qualities listed in the following summary should be present.

First, there must be a plan which will recognize and apply the various principles of sound investment practice giving full weight to the fact that fluctuations may occur, not only in the price of investments but also in the purchasing power of the principal or interest thereon due to possible change in the price level of commodities.

Secondly, the available funds must be of sufficient size so that a charge small enough to absorb no appreciable part of the earnings will produce sufficient revenue to provide all desired statistical data and services, while permitting the payment of such salaries as will hold highly qualified men in whose hands may be placed safely full managerial responsibility, who can devote their full time to serving the interests of the fund, and whose sole concern is in investing it with freedom from any investment bias or conflicting interest. In other words, investment management should not be a side line for some busy officer of a bank or trust company. Finally, the structure of the fund must be such as to assure that the owner receives the full earnings, subject only to a reasonable and fixed management charge which will be sufficient to meet the above expenses and to assure a fair profit to the management. The plan should also make it possible for the investor to know that for every dollar paid into the fund he will receive full asset value under his participation and that there is no premium paid for good will or so-called managerial ability; he should be further assured that when

he desires to dispose of his investment it will be liquid and that he will promptly receive his full proportionate share of the value of the underlying assets.

THE PERSONNEL

Having conceived a plan which will satisfy each of the above requirements, those responsible must finally decide whether they will be able actually to secure the experienced investment men necessary to insure the development and administration of safe and sound investment policies. This is a most important decision for, if the fund cannot be assured of management of the highest grade, it would be better if it were never started. Obviously the name of the bank or trust company concerned would be seriously affected if it were to associate itself with the establishment of a fund which afforded only mediocre management.

Assuming that the fund shall be operated solely from the viewpoint of the investor and that proper administration is assured, we come to consideration of the form which the fund shall take and the machinery to be used for deciding policies and building an organization which shall safely and profitably follow them.

METHOD DEvised BY THE INVESTMENT MANAGERS COMPANY

In 1924 the Investment Managers Company, now affiliated with our Company, undertook to create such an organization by which the best investment management to be commanded might be applied to the funds of individual and institutional investors. The first thought was to manage each in-

vestor's funds separately, much as a trust company handles trusts committed to its care. However, as sound management is often obstructed by the diversion of attention to a multiplicity of details, a method was devised by which the funds of many investors could be combined into a single fund, under a single trust indenture, which would keep the investor's interest clearly defined and not subject to changes such as frequently occur under a corporate structure.

Under the plan adopted by that company and continued by its successor, the Irving Investors Management Company, Inc., each investor subscribing to one of our trust funds receives a certificate of beneficial interest in that fund. By the terms of the indenture under which his certificate is issued by the Irving Trust Company, as trustee, he creates in effect, through such subscription, a separate voluntary revocable trust, and is entitled to a separate accounting with respect to the income derived from his proportionate share in the assets of the fund to which he has subscribed. As these certificates represent separate trusts, they are not transferable. However, the creator may at will repossess himself of his proportionate part of the assets in the trust fund by termination of the trust represented by his certificate, or may assign the right to demand redemption of his certificate, thereby making it available as collateral.

You will readily see the difference between this structure and that of the British type of investment corporation issuing the usual corporate securities, all of which are subject to the same sort of market fluctuation as are other corporate issues. The asset value behind the certificate of beneficial in-

terest representing separate voluntary trusts under such management varies from time to time, but since the certificates are not dealt in in any market, they do not attain any fictitious values, either above or below this asset value. In this respect they resemble the usual trust administered by an individual or corporate trustee. The difference is that through such a fund the assets of the various trusts which are created from time to time are combined under a single trust indenture into one fund to permit effective management.

SUPERVISION BY THE MANAGEMENT COMPANY

To accomplish this, the fund, held by the Irving Trust Company as trustee, is supervised by the management company, which, under a strong board of directors, has built up an organization devoted solely to the interests of these funds. To pay for this service, a charge is made against the funds at the end of each quarter, amounting to one-quarter of one per cent of the asset value. This management charge, together with the entrance fee of one per cent and the redemption fee, also of one per cent, constitutes the only operating charge against participations.

We have, then, a management company equipped to apply sound principles of investment management upon what might be termed a professional fee basis to the funds of numerous investors, trustee with a separate company. The charges for services rendered are fully disclosed and strictly limited. All earnings over and above these charges belong to the subscribers to the fund. New subscribers may add a suitable proportion of their investment resources at any time, and

receive their proportionate interest in the fund's earnings from the date of their subscription. Existing subscribers may withdraw at any time and receive their proportionate part of the value of the assets as of the date of withdrawal.

THE FUNCTIONS OF INVESTMENT MANAGEMENT

Under such a plan it becomes necessary for the managing company to perform the principal functions of investment management. These, we believe, are:

1. It will first establish a sound investment plan suitable to the purposes of the investor.

2. It will then determine what proportion of the fund under its management shall be in equities and what proportion in bonds or other maturing obligations, having in mind current industrial and economic conditions.

3. It will put itself in a position to watch for changes in conditions and be prepared to modify these proportions in harmony with such changes.

4. It will study the current conditions of various industries and groups of industries, and will select as its field a diversification of those which, upon reliable data, may be regarded as the more promising.

5. It will then examine the management and financial structure of the leading companies in these industries.

6. It will watch for changes in the conditions of both industries and individual corporations and be prepared to change the investment to accord with sound analysis of the latest available information.

7. It will retain diversification as its fundamental principle, but will establish reasonable limitations to diversification in order not to dilute the quality of management applied.

After the decision that investment management must perform these seven functions, the next step is to develop the organization to make these functions effective and to secure the type of attention called for by the following quotation from an annual report of the Carnegie Corporation: "The funds of a great endowment can be kept intact only by a systematic revision month by month of all the securities of the endowment and by a continuous process of sale and exchange as circumstances may affect the financial soundness of this or that security."

FLUCTUATIONS IN VALUE OF SECURITIES

We live in a world of constant change. The speculative security of yesterday is the prime investment of tomorrow. And the more we study the realities, the more we find that every type of security fluctuates in value either obviously, as in the case of stocks having a free market, or more subtly, as in the case of maturing obligations such as bonds and mortgages, where the fluctuation may be in part concealed. In supervising investments, then, we are dealing with risks, and the sooner we recognize this fact, the sooner shall we be able to serve effectively those who call upon us for the management of their invested funds.

TRANSFERRING OF FUNDS AND DIVERSIFICATION

A major risk is that inherent in unseasoned securities. Therefore, the plan for an investment trust of the conservative type will contain restrictions against investing in newly floated

issues which have not established their market. Again, there are advantages to be gained by transferring funds at intervals from one investment market to another, and the trust should, therefore, operate in a field wide enough to provide ample diversification and to permit shifting the funds from one industry or class of securities to another, so that, when one group furnishes a less favorable opportunity for investment than another, commitments may be transferred from the less to the more favorable. But this can be wisely undertaken only by an organization thoroughly conversant with the influences affecting the relative desirability of one security over another at different times.

RESTRICTIONS UPON THE MANAGEMENT

As a result, after ascertaining that the trust has a broad enough field in which to operate effectively, it may be desirable to learn whether or not this field has any limits. Some contend that there should be no restrictions of any kind upon the management, if that management can qualify under high standards of character, knowledge, experience and freedom from bias. But, in departing from the field of old line legal trust investments, new responsibilities are taken by trust companies or investment funds adopting a different means of serving their clients. If the new form of investment management service is thus to be undertaken without the legal restrictions and traditions of older trust management procedure, it is advisable that a set of voluntary restrictions be established, by indenture or otherwise, which will define clearly the nature of the proposed investment policies.

These will serve in the first instance to put the investor on formal notice with regard to the management's viewpoint, and will also furnish the necessary protection against an unsound psychology, which at times attacks even the most conservative boards and finance committees if the field within which they are to invest is without limit. History is replete with examples of eminent trustees and administrators who have been carried away by speculative illusions of their times to the detriment of the funds for which they were responsible. For this reason, those who fully realize the implications of investment management for others, particularly when this function is exercised under the auspices of a bank or trust company, will show the world that they are aware of their responsibilities by limiting their field of operations through the establishment of published restrictions—restrictions designed to protect the undiluted investment viewpoint, as opposed to the mixed viewpoint of investment advice combined with promotional activity which has made itself apparent at almost every stage of financial history.

And so it seems important first of all that some restriction be placed upon the number of different issues which may be held in the fund. This will assure that close contact can be maintained with all companies represented in the investment list and will rule out any number in excess of the maximum with which the management feels it is possible for the staff to keep in touch. As the fund grows, thus warranting a larger personnel, the number of issues permitted may be correspondingly increased.

A further important restriction should be in the direction of placing

a limit upon the percentage which may be invested in any one industry. Here again, history presents the picture of well-informed financiers placing too great a proportion of the funds for which they are responsible in an industry with which they may have too intimate knowledge, to the exclusion of a general knowledge of economic conditions which later overwhelm that particular industry. And, certainly, it is important to set a limit upon the proportion to be placed in one industry, how much more necessary it is to see that a disproportionate share of the fund is not risked in any one company. In fact, it might even be desirable to direct, as has been provided in our funds, that no investment shall be made in any one company beyond a point of holding, say, 10% of the company's outstanding voting stock, as a further insurance against the possibility of the management's perspective being warped.

The American public will read deeply into the record of some periods of British trust company history, and will take pains to insert in their trust indentures restrictions against the trustee's and its successors' activities, so framed as to make impossible a repetition of the unfortunate experience which befell the directors and investors in some of the British trusts organized under the spell of enthusiasm. Therefore, even though the character of management will always remain of first importance in the appraisal of an investment trust, the restrictions imposed upon it must be carefully considered.

LONG OR SHORT TERM RISKS?

Assuming that satisfactory restric-

tions have been established by trust indenture, our investment management organization is ready to operate. But shall it confine itself solely to bonds and mortgages, or to stocks, or to a combination thereof? An investment fund confined to bonds and mortgages represents a long term speculation in the future cost of living; confined to stocks, it represents a shorter term speculation in industrial and credit conditions and in the market psychology of the moment. Neither constitutes a sound investment program.

To the extent that law and language are competent to remove risks from mortgage bonds, they may have been eliminated. But the chief risk connected with the long term holding of such securities has not been removed from a majority of issues. It lies in the field of economics, beyond the reach of mortgage clauses. Omitting fluctuations due to changing credit conditions within a particular company, it exists on the one hand in fluctuations in the purchasing power of the dollar, and, on the other hand, in long term changes in the general level of interest rates.

However, assuming a partial investment in bonds, we have a choice between long and short maturities. An examination of the record will disclose that, during any short period of time, the risk of loss in purchasing power of the dollar is relatively small, while the possibility of loss through changes in interest rates is somewhat greater, increasing with respect to each bond in proportion to the length of time to maturity. To protect dollar values, then, we are likely to select short rather than long maturities. We shall be still further led in this direction by the discovery that the price of

long term bonds in general tends to fluctuate in the same direction as the price level for diversified common stocks, though to a lesser degree.

DIVERSIFICATION ELIMINATES RISKS

On the other hand, various studies indicate that during a period in which bonds are favored by declining commodity prices, a sound diversification of common stocks, if held sufficiently long to avoid the effect of short term market swings, is neither better nor worse for the long term than a similar investment in high grade bonds; while it remains true that in a period favoring stocks the latter show far superior investment results. Certainly, stocks can be speculative enough over a short period of time, as recent history amply demonstrates, but the long term underlying trend in the value of a well selected list of common stocks, representing leading, well managed industries, has been consistently upward in this country for as long as the records are available. And, by spreading the commitment over diversified holdings in such companies, it has been found that risks of this character are effectively eliminated through the application of the same principles which make the writing of fire and life insurance policies profitable. The law of averages has been found to favor such a diversified holding of common stocks. Every investment, no matter what its character, is, by itself, subject to special hazards. The science of investment, like that of insurance, consists of appraising the character of unavoidable risks and of neutralizing them through combination.

Therefore, where investments are made with the future happiness and

comfort of families as their object, or to provide income for educational and charitable institutions to help defray operating expenses at such price level as may prevail in future years, investors should ponder well the form of security in which their funds are invested—should carefully consider the effect of possible changes in fundamental conditions upon the relation of future income to future outgo. Such investors may offset any probable change in the level of commodity prices by placing a part of their funds in securities representing commodities or, in other words, in common stocks which reflect equities.

COMBINING SHORT TERM AND LONG TERM RISKS

Bearing in mind, then, that equities in the form of diversified common stocks represent a short term and bonds a long term risk, we may start with the simple proposition that combining the two risks, by holding one-half of a fund in bonds and the other half in equities, tends to neutralize both hazards. In undertaking the management of invested funds, this is perhaps the simplest formula from which to start, and in managing the two trust funds for which our affiliated company is responsible, it lays great stress upon the maintenance of a balanced position as a prime element in the protection of capital values, while permitting the resources of subscribers to participate conservatively in our industrial progress.

Accepting, then, as a general policy that the plan of the fund shall contemplate an open-minded position as between stocks and bonds and assuming at the start that with a view to protecting the investors' dollars, fu-

ture changes in commodity prices are hedged by a 50% purchase of diversified high grade stocks and possible changes in credit conditions and market psychology are hedged by a like purchase of bonds or preferred stocks, we now come to the next function of management—the determination from time to time of changes in the proportion to be maintained in each class.

NECESSARY CHANGES IN THE PROPORTION TO BE MAINTAINED

Starting from this insured and balanced position, the manager who can foresee changing economic conditions will be forced in the interest of his funds to adjust the proportions to conform with his appraisal of such altering conditions. He will recognize, for example, that insurance against a loss resulting from a sudden shrinkage in the market value of all the various stocks in a fund can be obtained by holding short term obligations readily convertible into cash, which may be used for investment in the same or other shares under more favorable conditions. He will know on the basis of past experience, that this type of insurance yields its own investment return, because interest rates on liquid funds have always been high when stock prices as a whole were in jeopardy; and when interest returns are low, the hazard to stock prices is at a minimum. It follows that, when current interest rates are high, the larger part of any conservatively invested fund will be in short maturities; when they are low, the larger part will be in equities or common stocks. At no time, however, will all of the fund be wholly invested either in equities or in maturities.

It is obvious, therefore, that properly to discharge the obligations of effective investment management requires the presence in the organization of some one competent to appraise in broad terms what these proportions should be at different times—some one whose appraisal will be based upon a scientific study of past records rather than upon intuition or hunch.

CHANGES BASED UPON LONG TERM ECONOMIC TRENDS

Inasmuch as the plan calls for the purchase and sale of securities and frequent reference has been made to changes, it seems well to emphasize at this point that although changes are essential, both in the proportion of maturities to equities, and again as between different industries or particular securities, investment management does not concern itself with day to day switches with a view to obtaining trading profits. Rather it will concern itself with changes based upon probable long term economic trends recognizing that no matter what investment policy it has established, it must stand ready at all times to change its commitments as it may become aware of any influences tending to make its position unsafe.

CAREFUL STUDY OF THE FIELD

The fund's managers must recognize that from time to time certain industries run into periods of prosperity, while others are suffering depression. Some may appear to have a long future of gradually increasing profits, while others fluctuate in earning power. A division of the organization should be specially devoted to a study of the relative prospects of

industries, both for the short term and for the long.

There should be another group devoted to a more intensive study of different companies within the more promising industries, investigating published figures, and making personal contacts through which intimate knowledge of the immediate prospects of the various companies may be gained. A part of the investigation will deal with figures, and a part with the human element, with markets, and with public relations, as they may affect the particular company. Assuming that such investigations convince the management that the securities of a company are promising, other specialists should then be called upon to examine general stock market conditions, the price of the issue in question, and its position marketwise. Needless to say, the security should be purchased only after it is determined that it not only gives promise but is in a satisfactory price position.

Thereafter, the duties of effective management require that those charged with supervising the fund be ever watchful to note varying conditions within industries and corporations in order that those changes in holdings may be effected which appear to be to the best interests of the participants; finally, at all times the management will depend for safety of the fund upon the most important principle of insurance, namely diversification.

SUMMARY

Reviewing the seven functions, it would appear first that a careful adherence to the general principles of insurance by suitable diversification of investments between high grade stocks

and bonds, and varying the proportion thereof to meet changing economic conditions is of primary importance in effective investment management. Second, the managers must be competent to note and take advantage of changes in the economic and financial fabric of the country, as well as to avail themselves of full information affecting industries and the major companies representative thereof, to the end that the group funds may be placed only in those securities where a minimum risk is combined with a promising future.

The services of an organization dedicated to following such principles should afford an effective investment management of group funds which will provide, first, protection at all times against permanent loss of capital values, and, second, the highest return in net income and appreciation that may be obtained without hazarding the safety of principal.

The summary as I have just phrased it may sound reasonably simple, but I am only too well aware that the few highlights I have been able to touch upon hardly cover adequately the manifold details of duties, methods, procedure, research and personnel. In fact, I have deliberately omitted any mention of the highly important accounting problems involved as well as mention of the necessity of providing participants in such funds with individual statements of income and profits to be included in their own income tax returns.

I have, however, sought to present some of the more important considerations, believing it to be of vital importance in contemplating the establishment of an investment management service that the multiple responsibilities to be assumed should be carefully

weighed, as, once accepted, they must be discharged without valid cause for criticism, lest resulting dissatisfaction react unfavorably upon the sponsoring bank or trust company.

Discussion

MR. CROWDER (Illinois National Bank): How large must the fund be to be properly effective?

MR. MCKERNAN: It is our belief that if the fund is less than \$20,000,000, the charges per unit which would be reasonable enough from the point of view of the investor would not produce sufficient revenue to buy the quality of management which we feel to be necessary.

W. R. HENMAN (Grand Valley National Bank, Grand Junction, Colorado): Assuming that the bank or trust company owned and operated or managed the affiliated company that had charge of this investment fund, would that, in your opinion, violate the national banking act which provides that the assets of each estate shall be kept separate and apart from each other?

MR. MCKERNAN: If a participation in such a fund were found in an estate or, under proper authority, purchased for a trust, that participation itself would be an asset of the estate and so long as it was kept separate there would seem no difficulty on this score.

MR. HENMAN: Then you would feel there should be authority in the instrument itself?

MR. MCKERNAN: Yes, either to retain such a certificate if found in an estate, or to purchase it if a new investment. We would not feel that a certificate was a proper investment for funds under our supervision unless

there was not only a provision giving us full discretion to hold investments found in the estate or to purchase new ones, but also directly authorizing the purchase of participations in the specific fund. In other words, we would want to be sure that the testator or grantor had given us discretion to make such an investment only after having considered the various features of the fund.

E. FLOYD GRIFFIN (Oyster Bay Trust Company, Oyster Bay, New York): This question has been partially answered, I think, but for the benefit of those who were not here before, I would ask this: Having in mind the theory as to stocks for investments upon which your fund seems to rely to an extent, what would be your opinion as to a bank's holding bonds?

MR. McKERNAN: In other words, are bonds the proper form of investment? Absolutely, yes. Banks, insurance companies, and similar organizations have dollar obligations as their liabilities, and the question of change in the purchasing power of the dollar does not affect their future need for funds. As a result they are justified in holding assets consisting of maturities payable in definite dollar amounts. Their responsibilities in this respect should be differentiated from those of the individual or institution whose future obligations usually are not to provide funds to meet dollar liabilities, but to provide purchasing power to meet future living costs which, of course, vary with the purchasing power of the dollar.

EARL KRATZER (Pioneer Trust & Savings Bank, Chicago): Mr. McKernan, what do you feel is going to happen when every bank and trust company starts such funds?

MR. McKERNAN: Our thought

is that when and if such a time arrives there will be many funds operated by managements which, because of distance from the logical centers for such work or because of the small size of the funds, or because of the neglect of some essential of good management, will render such mediocre supervision that even the reputation of the more sizable and well managed funds will be adversely affected; at the same time discredit will be cast upon the name of the bank or trust company associated in the management of the particular fund.

E. V. KIRKPATRICK (Missouri Valley Trust Company, St. Joseph, Missouri): Mr. McKernan, do you give lists of the securities held in this fund to the participants, and if you do is it only on application?

MR. McKERNAN: Each participant is entitled at the end of each fiscal year to receive a list of the securities as of that date. These lists are published in the annual reports of the two funds. The management company does not obligate itself to make them public at any other time. The objections to making them public at all times are several. First, such a list could be misleading because the investor might feel that any security appearing therein was recommended as an investment at that particular time while in reality the management might have selling orders entered for disposal of the issue. Second, publication of such a list might lead to discussions of the reasons for selection. The service for which the company is employed by the investor is to manage funds and not to broadcast investment information. The fund is operated with a view to supplying the most economical, high grade management possible, and many investment experts re-

port that experience has proved that one of the most expensive parts of investment management is discussing investment information and reasons with people who are not qualified to understand. The third objection is that through the availability of such lists some individuals with small participations might secure investment information for use as a basis for managing personal funds many times the size of their participations.

JOHN W. KRESS (Howard Savings Institution, Newark, New Jersey): What percentage of the fund is invested in mortgages, bonds, preferred and common stocks?

MR. MCKERNAN: It is impossible to give any percentage as a guiding one followed by the fund, because it varies from time to time to accord with the view of the managers as to future trends. At the time of the market break of last October, approximately 78% was invested in maturing obligations, such as prime bankers' acceptances or in call loans. As brought out in the course of the paper, the managers of the fund must be ready at all times to revise the holdings of the funds as between ma-

turing obligations and equities to conform with their appraisal of future economic conditions.

J. S. KENNEDY (International Trust Company, Denver): Do you sell these only to trusts or to individuals who do not have trusts?

MR. MCKERNAN: Participations in our present funds are not intended as trust investments. There are several reasons; prominent among them is the fact that you cannot very well place a trust participation in another trust inasmuch as you are taking out of the second trustee's discretion, decision as to investments and placing it in the hands of some one else. Secondly, an investment in a trust participation would raise various questions as to the respective rights of remaindermen and life tenants which would ordinarily make it an unsatisfactory investment for a trust fund. Instead, our present participations are intended for the individual investor. However, our company is at present developing a supplemental fund with a corporate structure which will be in a position to issue participations which would not present objections when included among trust funds.

Sales Arguments for Trust Prospects

By A. B. CULBERTSON

TRUST OFFICER OF THE FIRST NATIONAL BANK OF FORT WORTH, FORT WORTH, TEXAS

Address before the Denver Departmental Conference

Mr. Culbertson offers valuable and effective sales arguments for trust prospects. The lack of full information is the most frequent reason that the prospect has not already availed himself of trust facilities. This means, obviously, that the first task of the trust solicitor is to convey proper information to his prospect. For example, the prospect usually does not realize that the law has already made a will for him in the form of the "law of descent and distribution of the state," and that unless he draws his own will, his estate will pass according to the will provided by law.

In order to convince a man that his wife should not be named executrix, Mr. Culbertson has listed twenty-two duties that she must perform under the Texas law. These vary, of course, in each state.

There are many reasons why property should not be left to heirs in a lump sum. The arguments supplied in this article are entirely convincing with regard to this fact.

Mr. Culbertson presents, in addition, twenty-one excellent arguments for the use of the life insurance trust. With such a battery of facts to supplement one's persuasive powers, it should not be difficult to win over the prospect.

I SHALL make no attempt to offer a paper on salesmanship, for the very good reason that I know very little about scientific salesmanship. This paper will assume a knowledge of the principles of salesmanship and upon that assumption offer some suggestions to be used by trust solicitors in selling trust service.

The prospect to whom we are to sell has not already availed himself of our trust facilities, either because he has not been informed about them, or because he has not been convinced that we could best serve him and his

heirs. The lack of full information is in most cases the cause of this latter condition. The first task of the trust solicitor, therefore, is to convey proper information to his prospect. Local laws and conditions will require somewhat different technique in presenting sales arguments, but in general the same sales arguments that would be made in New York would be effective in Texas. Many of the sales arguments I shall give will be regarded by the experienced trust men as trite. However, a great many of you have no experience, or at most very little experience, in the trust

business in general and in trust solicitation in particular, and I am going to assume that you know nothing about it and present the selling points most frequently used, both in solicitation and in advertising.

SELLING THE TRUST IDEA

Our first problem is to inform our prospect about the trust idea in general. I have found that the average man in Fort Worth knows very little about our trust functions. He has read our advertisements and gained a vague idea about our trust services, but he has not thought of it as being practicable and something that he can use to meet his own needs. When we approach him, we have to tell him about the trust plan in general, how it has been in operation in other sections for many years, how our own bank obtains its powers, and the laws and regulations under which it operates; in general we must sell him our own institution. There are two questions uppermost in the minds of our prospect:

1. What would happen to my estate if the bank should fail?

2. What assurance have I that the present conservative management and policies of the bank will be maintained?

These questions are pertinent and must be answered satisfactorily before we can proceed with the discussion of specific needs and problems. If your bank or trust company is a member of the Federal Reserve System, you can recite the provisions of the Federal Reserve Law, which require that separate quarters be maintained for the trust department, with officers elected by the board of directors to supervise it.

You can also point out that trust funds cannot be deposited so as to be used by the bank, unless securities approved by the Federal Reserve Board are deposited to secure them; that securities and all trust investments must be kept under joint control; that trust assets cannot be mingled with bank assets or the assets of any other trust; and that consequently the bank cannot use them in its own business or profit from them in any manner. Therefore, if the bank should fail, the trust assets would remain intact and a successor trustee be appointed to administer them. It is necessary to become thoroughly familiar with the Federal Reserve Act and regulations promulgated by the Federal Reserve Board, with particular reference to trust assets when a bank is liquidated, as well as with the trust laws of your state.

The second question is not so easily answered. We point out that our bank has followed the same conservative policy and enjoyed the same safe management for over half a century; that with the strong interests back of it, we have every reason to believe it will continue these policies and this type of management. We must be thoroughly familiar with the history and management of our institutions and be able to point out that through the years they have successfully invested and managed the millions of dollars deposited by their customers, with little or no loss, and have succeeded in building up large surpluses and profits. We may point out to our customer that he must entrust the management of his estate to some one; that there is a degree of hazard connected with any plan he may adopt. Would it not be less hazard-

ous to entrust his estate to the care of a perpetual institution where a group of experienced men would handle it under government supervision, than to entrust it to one or more individuals who have no greater lease on life than the officers and directors of our bank?

ESTATE ANALYSIS SERVICE NECESSARY

While the sales arguments may be classified under executor, guardian, testamentary trustee, trustee under living trusts, and trustee under life insurance trusts and under other personal trusts, it is necessary in order to do effective selling that the whole estate of the prospect be analyzed and a plan worked out to supply the needs and effect the objectives of the prospect. We should know something about the man, his business, his family and what he desires to do with and for them. With this information, we can then draft a plan for the distribution and management of his business, his investments, his properties, and his life insurance. A plan to put his life insurance in trust, if not properly related to his general estate, may not be the plan that will serve him best, or will provide an effective selling argument. Blanks may be provided on which the prospect is requested to give the information necessary for an analysis. Once we are in possession of all the necessary facts, we can formulate selling arguments to fit his particular needs.

EXECUTOR AND TESTAMENTARY TRUSTEE

Having obtained the necessary facts by an analysis, we are prepared

to present to our prospect the need for an experienced executor of his will. We may first, however, face the difficulty of persuading him to make a will. We can point out to him that the law has already made a will for him in the form of the "law of descent and distribution of the state" and that unless he draws his own will, his estate will pass according to the will provided by law. It frequently happens that he believes he needs no will, as his wife will get all of his property anyway. All states have somewhat different laws of descent and distribution and we must be familiar with those laws in order to point out the fallacy of his belief. If he has made a will, he has usually named his wife as executrix, believing that this is the most economical and most satisfactory plan. Only in rare cases do men name a friend as executor. In order to convince a man that his wife should not be named executrix, or that he should at least name a coexecutor with her, I have found that a review of the things she will have to do as executrix usually gets him interested. I have listed twenty-two things that she must do under our Texas law, which are as follows:

1. File application for probate of your will
2. Get out "citation on application" to probate your will
3. Present witnesses at hearing on application to probate will
4. Have appraisers appointed to make an inventory and appraisal of property; have inventory returned and approved by the court
5. Advertise for claims against the estate
6. File preliminary report with the comptroller at Austin within ninety days, showing schedule of property

7. Have appraisers appointed to appraise the estate for Texas inheritance tax purposes
8. File notice of death of testator with the federal collector within two months
9. File report with the federal collector, showing
 - a. Value of gross estate of deceased
 - b. Deductions allowed by law
 - c. The value of the net estate
 - d. The tax payable on the estate.
10. Pay federal estate tax within one year unless time is extended
11. Make reports to other states where companies whose stock is held by the estate are incorporated, and obtain waivers where necessary
12. Within one year file final report with the state comptroller and pay inheritance tax
13. Pay all expenses connected with the last illness and burial of the deceased
14. Set aside allowance for widow and any minor children
15. Set aside exempt property for use of widow and minor children, or cash in lieu thereof
16. Set aside homestead or cash in lieu thereof, for widow and minor children
17. Pass on claims and pay those allowed and defend action against those disallowed
18. Collect debts due the estate
19. Pay all local taxes and unpaid income taxes
20. If cash is not available to meet the above demands, sell property to obtain cash
21. Distribute the legacies and bequests
22. Close administration.

You will, of course, consult the law of your own state to provide a similar argument. We then ask our client if he should place such a load upon the shoulders of his wife at a time when she is least able to bear

it. If he has named an individual other than his wife as executor, we may suggest to him that the average individual may not administer more than one estate in a lifetime and will have to gain experience by experimenting on his estate. I have frequently aroused the interest of the prospect by asking him how many estates he has ever administered. This calls to his attention the fact that his friend has probably not administered any more estates than he has. The individual may die before the estate is closed, and the court would in such cases be required to appoint an administrator to continue the administration, whereas if the bank or trust company is named executor, it will have continual existence. The bank or trust company is usually able to administer an estate as executor more economically than can an individual, because it has all of the facilities for handling the various problems that will arise, such as legal questions, accounting, looking after the protection of real property, investigating and disposing of such investments as may be necessary to pay debts, and a great variety of problems peculiar to each estate.

If the prospect insists on having his wife or an individual as executor, then we can suggest to him that he name the bank or trust company as coexecutor to work with her in administering the estate. This suggestion usually meets with instant approval, as it meets the objection that the wife usually raises to having some one handle the estate for her.

PROPERTY SHOULD NOT BE LEFT TO HEIRS IN LUMP SUM

Having sold him on the idea of

using the bank or trust company as executor, we must then convince him that he should not leave his property to his heirs in a lump sum. There are various arguments that can be used. He may be entirely willing for his wife to receive all of the estate, to do with as she pleases, but he would not be willing for her to remarry, some other man to get the benefit of the estate, and his children receive nothing. A suggestion that he place the estate in trust, the income to be paid to his wife as long as she lives, with adequate provision for the education of his children and power to encroach upon the principal to relieve any emergency that may arise, and with the added provision that in case his wife remarries, she shall thereafter receive nothing, has been found to be a very effective selling plan. The usual dangers in leaving the property in bulk to inexperienced heirs can be advanced with marked success, because the average man already realizes these dangers. By showing him that he can make his testamentary trust flexible enough to take care of any situation that may arise and thus be certain that his estate will do the most for his heirs, we can usually close the case.

A short time ago, while trying to convince a customer that it was unwise to leave property in bulk to his wife, I asked him this question: "Suppose you were going on a journey, to be gone a year or two, would you be willing to place \$100,000 in your wife's hands and ask her to take it and invest it and protect it until you returned?" He promptly replied that he would not. Then I said, "You are going on a long journey from which you will never return, and it seems to me that you

should be as careful to protect the estate permanently as you would be for a short period." In order further to experiment, I suggested to him that he ask his wife what she would do with \$100,000 if it were given to her to manage. He did that and came back the next day and told me he was thoroughly convinced that he should make arrangements to protect his estate and that his wife was also convinced that such an arrangement was necessary.

If our customer insists that he would like to have his wife act as joint trustee, we usually point out that one trustee cannot bind the estate without being joined by the other, and his wife's absence might seriously delay or handicap the administration of the estate. We suggest that she be named what we call "advisory trustee," but that the bank be not limited in its powers so that her absence would affect its administration. This usually serves just as well as a selling argument and relieves us from the handicap of a joint trustee. If he expresses a desire to name a personal friend as trustee, we show him that a personal friend can only give the estate proper attention by sacrificing his own interest in so doing, and it is not fair or logical to ask a personal friend to do that. Moreover, the personal friend may die and plunge the estate into the court. If the friend is a successful man, he will not have time to attend to an estate, and if he is not a successful man he is not the proper person to act as trustee. On the other hand, the bank will not die, is never sick or absent, never takes a vacation, and has no other duties to perform except to administer estates in its care.

LIFE INSURANCE TRUST

In our efforts to sell the life insurance trust, we should avoid discussing the relative return from investments made by life insurance companies and trust companies. Such comparison merely creates competition between the insurance companies and the trust companies, which should be avoided. We must let our efforts at securing life insurance trusts be co-operative.

The same arguments for putting a general estate in trust can be used for putting life insurance in trust. The greatest virtue of a life insurance trust is that it can be made flexible enough to take care of any situation that may arise. If the insured directs that his policies be paid under any of the optional settlements, the company can pay only the amounts provided in such settlements. Sickness or unforeseen contingencies may arise that would require more than the monthly payments provided in insurance contracts, but the insurance company can pay no more. With a life insurance trust, the trustee can use such part of the principal as may be necessary to take care of any emergencies that may arise, to provide funds for the education of the children, to purchase a home for a daughter when she marries, and to supply any other needs that may arise from time to time. It matters not what the insured's needs may be: if he will take the pains to work out just what he wants, he can put it into a trust agreement so that his needs will be supplied.

The following are some specific needs that you can supply and some things you can do with a life insurance trust:

1. Provide a regular income for wife, mother, daughter, son, or other relative or friend
2. Arrange for sound investment of insurance proceeds
3. Provide for your beneficiaries the maximum income which can be obtained with safety
4. Provide for extra payments from principal under certain contingencies
5. Protect your life insurance proceeds against swindlers and unwise investments
6. Provide a fund to establish your son in business
7. Include policies now in force and those which you take out later
8. Provide for the education of your children
9. Be sure that your trust will be considered in the light of the beneficiaries' specific requirements
10. Make your policies payable to a trust institution, and direct the distribution of the money
11. Build up an estate by life insurance, and arrange for the payment of premiums through income on securities
12. Specify to whom the income from a life insurance trust shall be paid, in what amounts, and at what periods
13. Provide the ready cash for the expenses of settling your estate
14. Provide for the replacement of earning power, so that members of your family may continue to live in their accustomed manner
15. Secure wise financial administration of your money
16. Provide against forced liquidation of your estate
17. Choose either the funded or the unfunded form of trust agreement. (Under a funded trust, you deposit with the trustee securities sufficient to furnish income to meet the premiums. By the unfunded plan, you pay the premiums and deposit only the policies.)

18. Provide for safe investments and wise management
19. Provide ready money for the payment of debts against the estate
20. Put all your policies, even though from several different companies, under one trust agreement
21. Direct your trustee to confine the investments to securities of a certain type, or give the trustee power to act at its own discretion.

In conclusion, let me suggest that, if you are interested in obtaining a brief outline of the objections that are usually raised, and the arguments used to meet those objections, you will write to the Trust Company Division of the American Bankers Association, 110 East 42 Street, New York City, for its Sales Manual for Trust Service.

Discussion

LT. COL. K. C. MASTELLER (International Trust Company, Denver): I should like to ask Mr. Culbertson whether he asks his prospect, when the man wants to leave his estate entirely to his wife in a lump sum, whether he is interested in where the estate should go in the event of the wife's death. Of course, without a will, it would go to her heirs, and none of it would go to his, as a general proposition.

MR. CULBERTSON: Did you have reference to simultaneous death of the husband and wife?

LT. COL. MASTELLER: Death of the wife after the husband.

MR. CULBERTSON: We use that very effectively. As I suggested in the paper, we emphasize the fact that if the estate goes entirely to his wife and she remarries, her husband might

get the benefit of it, or if she dies without having remarried, it would go to her heirs and not to his heirs. We have a peculiar situation in Texas. In Texas we have what we call the separate property law. All the property acquired by the husband or wife before marriage and that inherited after marriage is the separate property of the husband or of the wife.

ARTHUR TIEDEMANN (Drexel State Bank, Chicago): What argument do you use if the prospect has had some sad experience in another department of your bank, has been turned down on a loan or something of that kind and is disgruntled with the bank, but nevertheless is a good prospect?

MR. CULBERTSON: Well, that is a very interesting question. I had that experience not so long ago. A man came in who had had an unsatisfactory experience with our loan and discount department and I laughingly remarked, "When you go to leave your estate, you ought to put it in the hands of an institution that is very careful about those things."

I knew the fellow pretty well and I discussed it with him in a spirit of levity. However, we got the trust. That just happened to be one case.

Of course, you have to use some tact. I never try to justify the attitude of the bank very much. It merely starts an argument, and everybody likes to believe he has been aggrieved.

W. R. HENMAN (Grand Valley National Bank, Grand Junction, Colorado): I think we all experience considerable inertia on the part of the majority of trust prospects. They believe that they will do a particular thing ultimately. They put it off, however, until tomorrow and the day after tomorrow, and so on. Just how

far should the trust salesman go in endeavoring to close up the prospect? In other words, should high pressure methods ever be employed? Would it be ethical: and how far should those methods go?

MR. CULBERTSON: That question would be relative, as most trust questions are. You can push some prospects; others you cannot push. Personally, I do not believe in any high pressure methods at all. I had some prospects it took a year to close: I have some I have been trying to close for a year and they are going to close if they do not die first.

THE CHAIRMAN: I might recite a little experience of mine in obtaining trust business from some of our prospects out on the coast. A long while ago when I first entered the trust service, I made my own will and I did in my will for my family what I could heartily recommend that any one else do for his family. We have endeavored to have all of our executive officers make their wills, and I believe with but very, very few exceptions, all of them have made their wills. We have asked a number of them who are well known whether or not they would object to our reciting to our prospects just about what program they made in their own wills. Invariably they will tell us they have no objection.

Then you talk to Mr. Brown who has a very hazy idea about what he wants to do. As a matter of fact, he really does not know what he wants to do with his estate. I have often reasoned with him. "Now, in my case, I have made my will in this way or that way, and in Mr. Jones', our vice president's case, he has made

his will this way or that way." That power of suggestion as to what others have done and what I have done, will convince him and suggest to him the very program I have adopted myself. I think that has been one of the means through which I, in a feeble way, have sold much of the trust business that I have been able to put on the books of my institution.

RICHARD J. SMITH (Michigan Trust Company, Grand Rapids, Michigan): I wonder if the fact that trust companies handle charitable trusts without fee of any kind could ever be used in advertising.

MR. CULBERTSON: We would not want to advertise that fact because we give enough free business anyway. I do not believe it would be of any advantage whatever to advertise charitable trusts.

MR. LOSH (First National Savings, Utah): I should like to ask if you have come to a definite decision on trust solicitation as to which form is the best method of advertising, that is, personal solicitation or newspaper advertising.

MR. CULBERTSON: We have just gone through a very interesting discussion in our adjoining room on that question. We think that newspaper advertising provides a good background for personal solicitation. Personally, I have closed some very good business from newspaper advertising, but I do not think you can compare newspaper advertising with trust solicitation for closing business. It will help to rouse interest and educate the people and get them to think about it, but I know of no substitute for getting out and talking to the prospect personally.

The Living Trust

By EDWARD C. KING

TRUST OFFICER OF THE INTERNATIONAL TRUST COMPANY, DENVER, COLORADO

Address before the Denver Departmental Conference

Mr. King divides his discussion of the living trust into two different phases: its sphere of usefulness; and its validity as against the personal representative of the deceased donor. The living trust, he believes, has two different uses: one being the purpose which it serves during the lifetime of the donor, and the other its use in effecting a disposition of the trust property after the death of the donor.

It is Mr. King's opinion with regard to the effect of reserved powers, that, assuming an otherwise valid trust, any powers may be reserved so long as the trustee is not deprived of all the duties which are ordinarily incident to the management of a trust estate, but that in every case this general rule should be modified to meet the requirements of the laws of the state in which, if the trust is attacked, its validity will be determined.

Mr. King supports his ideas not only by detailed and thorough explanations, but by the citation of various court decisions.

THE title of this paper involves two different, but related, aspects of the subject of the living trust: the first, its sphere of usefulness; and the second, its validity as against the personal representative of the deceased donor. The first is closely related to the second because if living trusts are inherently beneficial to the donor and his family, just as regards creditors, conducive to saving and thrift, and economical as a method of disposing of one's estate, they will continue to grow in popularity, and the courts, following the economic trend, will encourage their use and will be reluctant to question their validity. Moreover, if the device is desirable and economically sound, it must follow as a corollary that it is in accord with public policy. To paraphrase a statement in a recent decision of one of the New York courts, it must be true that if the act of a man in cre-

ating a trust which will encourage thrift and which will insure the investment of his funds in sound, non-speculative securities is consonant with the dictates of public policy, any arrangement which tends to add to the value of his act, such as the protection of his dependents after his death, should be entitled to even greater public favor. With this as a premise then, I will first briefly consider the living trust with regard to its usefulness or place in the economic structure, and then from the practical standpoint, attempt to state the existing laws relative to its validity.

TWO PURPOSES OF THE LIVING TRUST

In a discussion of its uses the living trust may profitably be divided into its two different phases or purposes: one being the purpose which

it serves during the lifetime of the donor, and the other its use in effecting a disposition of the trust property after the death of the donor. The value and the usefulness of a living trust for the services which the trustee may render during the lifetime of the donor depend to a great extent on the character of the donor's property, his business and investing experience, and the extent to which he travels or is otherwise absent from his home or office or is unable to give careful attention to the business of investing his funds. If he lacks time to care for his investments, or if he lacks experience or judgment in selecting and managing investments, if he travels extensively, or finds the problems of bookkeeping and accounting burdensome or annoying, either a safekeeping agency or a living trust is practically a necessity. If his capital is invested in tangible chattels or if he is engaged in trade to such an extent that his assets are constantly changing in form, the living trust is not entirely practical. But when a relatively important part of his property is in money, stocks, bonds, mortgages, or real estate, the living trust is practical. A trust of this type may be used for the purpose of creating, conserving, or distributing estates. It may be used advantageously in place of a savings account or a safekeeping account. By the creation of a trust of this nature, the donor can virtually assure, for the time limited by the rule against perpetuities, the preservation of his original capital and a net income equal to 5% of the principal. During his lifetime the donor has an opportunity to observe the methods of the trustee in handling the trust estate and if the trust is to continue after his death, can be fairly certain that

the management will continue in a manner satisfactory to his beneficiaries. These statements assume of course the selection of a thoroughly dependable trustee, expert in making and managing investments, carefully supervised, and capable of giving definite assurance of a continuing existence.

THE DISPOSITION OF THE DONOR'S PROPERTY AFTER DEATH

With respect to its second purpose, the disposition of the donor's property after death, a comparison of the methods by which one may dispose of his estate is, in most cases, distinctly favorable to the living trust. The three methods in common use, in the order of their present popularity (if any can be called popular) are: first, by operation of the law under the statutes relative to intestacy; second, by will; and third, through the medium of the trust. If that which is true is assumed as a fact, that is, that the fees paid to a qualified trustee during the lifetime of the donor are for value received, the economy in the disposition of the property through the medium of a trust as compared with disposition by will or under the intestate laws is extremely significant. Omitting from consideration inheritance and estate taxes, which we may assume will be collected in any event, the total cost of disposition of one's estate through the medium of a living trust and a qualified trustee, will seldom exceed $1\frac{1}{2}\%$, a low figure when compared with 4% to 6%, when disposition is made in any other manner except by an absolute gift *inter vivos*. In another respect the comparison is favorable, and that is in its simplicity. With the living trust

the petitions, notices, inventories, reports, hearings and orders, delays and court appearances, all of which are incident to the administration of an estate, are done away with. There is less publicity and less inducement to persons to make fraudulent claims against the estate, and in all respects the costs of dying are reduced to a minimum. The donor knows exactly what the cost of devolution of his property will be, whereas, when the estate passes by will or under the intestate laws, the deceased can never foresee with certainty the expense which will be unavoidable in the settlement of his estate in court even under the most careful executorship. It would seem that the living trust is a useful and economical device for the creation, conservation, and disposition of estates; that its use therefore should be encouraged; and that if created with proper motives and without intention of defrauding creditors, it should meet with more favor in the courts than any other plan for like purposes which has thus far been devised.

These matters, of common knowledge to all well informed lawyers and trust company executives, have been so thoroughly covered in textbooks, educational programs of trust companies, and magazine and newspaper articles, that any further remarks would be redundant, and I will pass to the second phase covered by the title: validity as against the personal representative of the deceased donor.

EXTENT OF VALIDITY OF LIVING TRUSTS

The general question which will here be considered is the extent to which so-called living trusts are valid

after the death of the donor as against his personal representatives. This question, however, cannot be covered in all of its ramifications in the time afforded. The writer will therefore assume a solvent and competent donor, an instrument purporting to create a trust, identified property, apt words of present conveyance, and beneficiaries definitely ascertained or definitely ascertainable by an act which has significance apart from its effect upon the disposition of the property. (Note 1) Special types of living trusts such as life insurance trusts, business insurance trusts, and trusts in which the donor is also trustee, will not be considered except as they may be included in general statements applicable to all living trusts. State statutes will not be discussed, but it will be assumed that every state has a statute of wills which prescribes a method for the testamentary disposition of property, and that any testamentary disposition not made in compliance therewith is invalid.

RESERVATION OF POWERS BY THE DONOR

Having made these assumptions, there remains only the specific question: What powers may be reserved by the donor without making the trust testamentary? It is this question which has vexed attorneys and trust executives and its solution is imperative. Impelled by a desire to settle this question and to afford a basis for the adoption of some uniform rule with respect thereto, the Trust Officers' Association of the Denver Clearing House Banks performing trust functions, in the summer of 1929 appointed a committee consisting of Robert L. Stearns, of the law firm

of Lewis and Grant, John L. J. Hart, also an attorney, of the Trust Department of the Colorado National Bank, and the writer, to make a study of the law relating to living trusts and to report to the Association. The Committee, with the assistance of other attorneys, made an examination of probably six hundred cases, of which the more important were briefed. In addition the leading English and American textbooks on the subject were studied, together with current articles in the various legal publications and trust services. During the course of its investigation the Committee found that a similar and probably more comprehensive survey was being made by a Committee appointed by the American Law Institute to prepare a restatement of the law of trusts, and through correspondence with Professor Austin W. Scott, Report for the Law Institute Committee, much valuable advice was obtained and it was found that in most respects his conclusions coincided with ours. The ultimate conclusions hereafter stated are in substantial accord with those of the Denver committee, but the blame for the theories advanced in support of the conclusions should not be put upon the committee.

A study of the cases and textbooks reveals some divergence of opinion and a lack of settled rules with regard to all but a few of the powers which may be reserved by the donor. It is settled law that if, by the terms of the trust instrument no interest passes to the beneficiary during the life of the donor, the intended trust is testamentary and invalid as against the personal representatives of the donor. (Note 2) No citation of authority is necessary

to establish this point. It is equally well settled that the reservation of a power of revocation alone does not make the trust testamentary. (Note 3) In fact it has been held that a failure to reserve a power of revocation is ground for cancellation. (Note 4) So far as I have been able to determine, it has never been stated, except in Ohio, that the reservation of a power of revocation rendered an otherwise valid trust testamentary, and the Ohio decisions (Note 5) were based on one or both of two fallacies: one being that revocable living trusts were novel and unauthorized devices; and the other that if a valid trust is to be created the donor must "finally and forever abandon all control over the fund during his lifetime." That neither of these statements was justified by precedent is evidenced by the fact that revocable living trusts had been used and their validity recognized for more than four hundred years before the Ohio decisions were written. (Note 6) There is no authority of consequence indicating that reservation of income to the donor for life, or of so much income and principal as is necessary for his support, will render a trust testamentary, even if coupled with a power of revocation. If, however, powers, in addition to those above mentioned, are reserved to the donor we strike the point where difficulty of decision begins and divergence in the opinion of courts occurs.

McEVoy AND WARSCO CASES

In the cases of *McEvoy v. Boston Five Cents Savings Bank*, decided by the Supreme Court of Massachusetts in 1919 (Note 7) and *Warsco v.*

Oshkosh Savings and Trust Company, decided by the Supreme Court of Wisconsin in 1924 (Note 8) the power to withdraw principal upon demand was held to create a testamentary trust. In the latter case the theory of the court was that while a power of revocation was proper, because its use would extinguish the trust, a power of withdrawal was bad, because through its use the donor could re-acquire the property pursuant to the terms of the trust, but as Professor Scott says, "This distinction would seem to be rather fine-spun." (Note 9) The McEvoy case was decided on the theory that during her lifetime the donor's rights as beneficial owner were not limited in any material way. While it has been attempted to reconcile this decision with seemingly contrary decisions of the same court (Note 10), it is the writer's opinion that the case must be regarded as an anomaly in the Massachusetts law. The McEvoy and Warsco cases demonstrate that the inclusion of a power of withdrawal may afford grounds for an attack upon the validity of the trust. In other cases the facts have led the courts to hold that the conveyance was colorable and not real, and that having the semblance of a gift, but the substance of a will, was nugatory, as where the deceased, in his lifetime, executed a bill of sale by which he sought to transfer property to his daughter and she at the same time executed a power of attorney by which the deceased was to receive the property and, during his lifetime, manage, control, and use the same. The property was delivered to the daughter and she in turn redelivered it to the deceased. It was held, in a suit against the executor

for failure to include the property in his inventory, that the property belonged to the executor; that while the delivery of the property was not incomplete for lack of formal assignment, there was a manifest mental reservation by the deceased which rendered the delivery incomplete. (Note 11) It should be noted that the daughter had none of the usual duties of a trustee. Of like import is a Colorado case (Note 12) in which the deceased in his lifetime conveyed certain real estate in trust to pay the income to him during his life, and upon his death "the trust shall thereupon cease and determine and the premises hereby conveyed shall thereupon vest in my son." The trustee did not exercise or attempt to exercise any control over the premises while the donor lived and the deed of trust was not recorded until after his death. In a suit by the administrator the court decided the issues in his favor on the theory that the conveyance was colorable only. The case of *Coston v. Portland Trust Company*, decided in favor of the administrator by the Supreme Court of Oregon in May 1929, (Note 13) is to the same effect. The trust deed was not recorded, the trustor held all the indicia of ownership, and there was change of neither possession nor management. The trust instrument purported to convey title but by its terms full and complete control was reserved to the trustor. While this case has been criticized, it appears to me to be sound. Such a transaction must be constructively fraudulent as to subsequent as well as existing creditors. If the trustee had recorded the deed, or had taken possession, I believe, and the court suggests, the decision might have been different.

SMITH V. FERGUSON

In the case of *Smith v. Ferguson*, (Note 14) a trust was declared to be testamentary, on the ground that to constitute a valid gift *inter vivos* it was essential that the property should be delivered absolutely and unconditionally, that it must take effect at once and completely, and that it must be irrevocable. The court states that gifts *inter vivos* have no reference to the future. It is my opinion that the courts have rather often confused two different types of gifts; one being the ordinary gift *inter vivos* and the other a conveyance to a trustee. The first must be irrevocable and the second may be either revocable or irrevocable. The distinction between the two has been drawn by implication in many well reasoned cases and directly in some cases. (Note 15) It is apparent that no revocable living trust will stand the test of the technical rules applied to ordinary gifts *inter vivos*. Even the Illinois Court has, upon occasion, drifted into this error. (Note 16) And the Wisconsin Supreme Court, while it may have decided the case correctly, applied the same test as recently as the year 1926. (Note 17) In the latter case the donor reserved full control of the property in question during his lifetime. It is true that the act which creates a living trust usually is, as its name indicates, a gift *inter vivos*, but the gift is not subject to the same tests which are applied if "A" in his lifetime gives a horse to "B", which is what is technically known as a gift *inter vivos*. The gift to the trustee is, by way of distinction, a gift in trust, or a gift to a trustee. (Note 18)

DANGER OF RESERVING TOO MUCH CONTROL

The cases mentioned illustrate the danger of reserving too much control, whether by the terms of the instrument or by the subsequent method of handling the trust property, and the above and numerous other cases demonstrate that in suits brought by the representative of the donor it may be claimed as against the trustee:

1. That the trust agreement created a mere agency which terminated at the time of the death of the principal
2. That the trust agreement was an attempted testamentary disposition of the property of the trust estate and was void because not executed in accordance with the statute relating to the execution of wills
3. That the agreement was a secret conveyance and as such was void as against all creditors, or
4. That it was merely colorable and was not intended to and did not vest any real title in the trustee.

A SECRET CONVEYANCE

The question of a secret conveyance can be quickly disposed of. It is probably the law (as illustrated by the case of *Coston v. The Portland Trust Company*) that if the donor holds all the indicia of ownership and there is no change of possession or management of the estate, the deed, whether absolute or in trust, is constructively fraudulent as to subsequent, as well as existing, creditors. The other three objections that may be raised (that the disposition is testamentary, that a mere agency is created, or that the conveyance is colorable only) stand in close relation to each other. For example, if there

is a purported conveyance of property to a trustee and the control of the donor is so unlimited that the donor parts with no real interest until his death, it may be said to be a testamentary disposition, a colorable conveyance, or the creation of a mere agency. Each of the three expressions is used to denote a failure to vest a present interest in the remainderman, and in every case the ultimate test must be whether a trust or an agency was created. If (although the conveyance was absolute in form) an agency was created, the conveyance was colorable only and the gift to the remainderman testamentary, and, conversely, if the gift was colorable merely or the gift testamentary, the relationship created must necessarily have been that of principal and agent. As one of our courts said, "If the defendant has not shown himself to be trustee, he must have been an agent of the plaintiff." (Note 19) This test has not been applied in many of the cases which have been before the courts in this country, but I believe it merits discussion. While in a few cases, sometimes because of peculiar facts, and sometimes because of faulty reasoning, the courts have refused to sustain what might be considered trusts, the majority of decisions, either directly or by implication, sustain the view that the determining factor as against personal representatives of the deceased donor or others is whether a trust or an agency was created. If this theory is correct, it is not improper to consider the characteristics which distinguish a trust from an agency.

Tiffany (Note 20) says: "For the solution of this difficulty no inflexible rule can be laid down; names are not conclusive, and a case must

be determined by the preponderance of the conflicting characteristics contending for recognition." In this connection the following rules may be noted:

1. A trustee has title to the trust property; an agent as such does not have title to the property of his principal, although he may have powers with respect to it.

2. An agent acts for and in behalf of his principal and subject to his control; a trustee as such is not subject to the control of his beneficiary, except that he is under a duty to deal with the trust property for his benefit in accordance with the terms of the trust and can be compelled by the beneficiary to perform this duty.

3. An agent may subject his principal to personal liabilities to third persons; a trustee cannot subject the beneficiary to such liabilities.

4. An agency is created by the consent of the principal and the agent; a trust may be created without the knowledge or consent of the beneficiary or of the trustee.

5. An agency can be terminated at the will of either the principal or the agent, and is terminated by the death of either. A trust is not ordinarily terminable at the will of either the beneficiary or the trustee nor by the death of either.

6. A person may be at the same time both an agent and a trustee for the same person. If an agent is entrusted with the title to property for his principal, he is a trustee of that property. (Note 20a)

DISTINCTIONS MADE BY THE SUPREME COURT OF THE UNITED STATES

The Supreme Court of the United States (Note 21) makes similar distinctions, saying that an agent represents and acts for his principal, who may be either a natural or artificial

person, while a trustee may be defined generally as a person in whom some estate, interest, or power, in or affecting property, is vested for the benefit of another; that when an agent contracts in the name of his principal, the principal contracts and is bound, but the agent is not; that when a trustee contracts as such, unless he is bound, no one is bound, for he has no principal.

Applying the test of "conflicting characteristics" to the most usual of the modern types of so-called living trusts, it appears that a true active trust is created and not an agency. Assume a solvent donor, apt words of present conveyance, a trustee designated as such, income to donor for life with remainder in trust for wife and children, power in the trustee to invest and reinvest, to sell or mortgage, to make decisions as to what is income and what principal, to create reserves, to issue proxies, to collect and pay income, to exercise rights, to take part in reorganization, to secure and pay for insurance, to appoint successors, to deduct fees and generally to hold and administer the trust property with the right reserved to the donor to revoke, to withdraw principal, and to amend the trust instrument, and the relationship created must be that of trustee and *cestui que* trust. Each additional power reserved to the donor, however, creates additional doubt.

POWERS NOT INVALIDATING THE TRUST

Thus far, with respect to matters upon which there is a divergence of opinion, only cases adverse to the validity of trusts have been mentioned. It is my opinion, however (and I will

attempt to demonstrate that by the weight of judicial authority) that in addition to the right to receive the income, any one or more of the following powers may be reserved to the donor without invalidating the trust:

1. Power to revoke in whole or in part, and through the exercise of such power to reach all or part of the principal of the trust estate
2. Power to modify or supplement, which includes power to change the beneficiaries
3. Power to direct, or consent to, sales, investments, and reinvestments.

STONE V. HACKETT, EXECUTOR

The following are the cases relied upon as supporting these conclusions:

Stone v. Hackett, Executor, decided by the Supreme Court of Massachusetts at the November term 1858. (Note 22) The case arose on a bill in equity to obtain instructions of the court and the disposition of property held by plaintiff under the following declaration of trust:

"This memorandum witnesseth: That I have in my hands 81 shares in the Eastern Railway . . . such shares standing in the name of Harriet Kittredge or Harriet P. Kittredge as trustee. The said several shares were purchased with the money of Dr. Rufus Kittredge . . . and are in my hands in trust for the following purposes and uses, that is to say: The income . . . to be paid to the said Rufus Kittredge during his lifetime; and at his decease, 20 shares . . . to go to the Trustees of Donation for Education in Liberia, Africa . . . said Rufus Kittredge retaining the right to modify said uses and to revoke said trust.

Ellen K. Stone."

It appears that in 1853 Dr.

Kittredge, having purchased the stock and taken certificates in the name of Harriet Kittredge or Harriet P. Kittredge, trustee (who had previously died after signing a declaration of trust similar to the above), sent the certificates with blank transfers indorsed thereon and signed by Harriet P. Kittredge to the plaintiff, Ellen K. Stone, with the above declaration of trust which she signed and returned to him. Dr. Kittredge died in 1854. The beneficiaries under the trust instrument insisted upon its validity. The widow answered that the stock enumerated in the declaration of trust was never delivered or transferred to the plaintiff, and that such transfer, if made, was testamentary in its nature and fraudulent and void. A. R. Hatch of New Hampshire for the widow argued that the transaction lacked the essential elements of a gift *inter vivos*, in which he said the donor must part not only with the possession of but the dominion over his property, and that the gift if otherwise valid was but an evasion of the statute of wills and a fraud on the widow. The court, by Bigelow, Judge, stated that the solution of the question was to be found in the well established, equitable principle that a voluntary gift or conveyance of property in trust when fully completed and executed will be regarded as valid, and its provisions will be enforced against all persons excepting creditors or bona fide purchasers without notice; that if the agreement or contract be executed by a conveyance of property in trust so that nothing remains to be done by the creditor to complete the transfer of title, the relationship of trustee and *cestui* trust is deemed to be established; that in the instant case there was a legal transfer of the property

fully executed with a full and explicit declaration of trust executed and delivered; that nothing therefore was left *in fieri*; that the transaction was a completely executed transfer of property and fully created a trust which, according to long established principles, a court of equity was bound to recognize and enforce.

JONES V. OLD COLONY TRUST COMPANY

The following is probably the leading American case: *Jones v. Old Colony Trust Company*, decided by the Supreme Court of Massachusetts in February 1925. (Note 23) This was a suit in equity by an administrator for the recovery of property alleged to belong to the estate of his intestate. The deceased had conveyed the property to the defendant trust company upon trust to hold, manage, and so forth, to pay the income to the deceased during her life, or in accordance with her directions, and at her decease to distribute among numerous named beneficiaries. Power was reserved to alter or amend the instrument and to require the trustee to pay over to the maker "at one time or from time to time such portion or all of the principal of the trust fund as may be requested." The court sustained the trust upon the authority of *Stone v. Hackett* (*supra*), stating that while in that case the instrument of trust was slightly less explicit than the one in the case at bar, it nevertheless contained unequivocal power of modification and revocation with requirement of payment of income to the donor during life. It says of *Stone v. Hackett* that the case has been cited many times, always with respect;

that it has been regarded as an unshaken authority and may be treated as a rule of property.

KECK V. MCKINSTRY

Keck v. McKinstry was decided by the Supreme Court of Iowa November 13, 1928. (Note 24) We consider this one of the most able opinions which we have found in our examination of this subject and believe that the conclusions and the reasons upon which they are based accurately reflect the correct and majority rule in the United States. The facts are substantially as follows: In June 1914 one John McKinstry executed an ordinary warranty deed to his son "Albert McKinstry, his heirs and assigns forever," conveying the land in question. On the same day he executed a declaration of trust reciting the execution of said deed, and stating that the land conveyed by said deed was to be held by the said Albert McKinstry in trust upon certain uses, among which were, that the maker during his lifetime should have the right of possession, the rents and profits, and all of the elements and rights of a life estate in the trust property; that after the maker's death the trustee should hold for certain other uses. The maker reserved the right to change or amend the provisions of the trust agreement and to demand and require the trustee to convey or transfer to him or to such other person as he should designate, such parts or portions of the trust fund as the maker might select and on such terms as he might prescribe. The suit was brought by Keck, substituted trustee, against certain heirs of Albert McKinstry and heirs of John McKinstry, the

maker. The petition prayed establishment of title in plaintiff as trustee and directions for administration of the trust. It was claimed as against the trustee that the trust agreement was testamentary only; that the trustor or maker retained the whole beneficial interest, including the right to incumber, to alienate, to appoint a new trustee and in short the complete power of disposal; that he parted with no dominion over the property, and that the trustee became his mere agent; that the agency was revoked and that the trust merged in the legal estate by the reversion to the maker on the death of Albert, the first trustee. In sustaining the validity of the trust the court said:

"Appellants rely on *Warsco v. Oshkosh Savings & Trust Co.*, 183 Wis. 156; 196 N. W. 829; *McEvoy v. Boston Five Cents Savings Bank*, 201 Mass. 50; 87 N. E. 465. These two cases involved certificates of deposit, the possession of which was placed by the so-called settlor in the so-called trustee. The trustee was required to pay to the trustor any of the amount of the deposit at any time. Those cases have no analogy to a conveyance of the legal estate in real property to one in trust for the use of the grantor during his lifetime and of other named beneficiaries and for distribution to them after his death. Here the legal estate in real property was conveyed to Albert McKinstry. It passed a present estate. By their agreement, the parties separated the legal and equitable estate. It is not claimed that the power of revocation invalidated the conveyance and declaration of trust as a trust. It cannot be claimed that the trust was merely passive. Active duties were imposed upon the trustee for the benefit of beneficiaries other than as well as including the trustor. It can make no difference

that the trustor retained the active management of the property during his lifetime, and that the performance of active duties by the trustee was postponed until after the death of the trustor, and that performance of the trustee's duties was contingent upon his surviving the trustor. The trustee acquired the legal title to the property, and in equity an estate to the extent that would be necessary to enable him to perform his duties. Manifestly that estate was in trust. The duties required of Albert McKinstry, whether in law or in equity, were not duties to a principal, a superior as such, to be performed for, and in the name of, John McKinstry. The acts of Albert McKinstry in the performance of his duties would not be the acts of John McKinstry. They would be his own acts and in his own name as trustee. The arrangement has no semblance either in name or purpose of an agency."

OTHER CASES IN POINT

Bear v. Millikin Trust Company was decided by the Supreme Court of Illinois October 19, 1929. (Note 25) This was a suit by three heirs of the donor to cancel a trust agreement by which the deceased in his lifetime conveyed corporate stock to the trust company. The instrument provided that the income should be paid to the donor during his lifetime and reserved to him the right to vote the corporate stock, and the right by will or deed, to revoke the trust deed in whole or in part or change or alter any of the trusts created by it. The court held that the powers reserved were only powers, and not estates, and did not enlarge the life estate; that there was a valid present conveyance; and that even though made in lieu of a will it was not a testamentary disposition of the property.

This is a very strong, well reasoned case.

Windolph v. Girard Trust Company was decided by the Supreme Court of Pennsylvania in 1914. (Note 26) This was a suit by a surviving husband to cancel a voluntary deed of trust of personal property executed by his wife in her lifetime, and for a decree that the property formed part of the assets of her estate. The trust deed provided for income to the donor for life, and reserved to her the right to rescind, revoke, or annul the trust in whole or in part and to change or amend the terms and provisions of the instrument. It was also provided that the trustee could not invest in other than legal securities without the donor's written consent. The husband contended that the deed was in fraud of his marital rights; that it was testamentary and that it was a mere nominal transfer—the standard objections. It was held that the trust was a valid non-testamentary disposition of the property.

Adams v. Hagerott was decided by the Circuit Court of Appeals, Eighth Circuit, in September 1929. (Note 27) Suit by Adams to be adjudged the owner, as trustee, of certain certificates of stock found among the property of A. D. Gaines, deceased, and praying that the administrator be required to deliver the certificates to him. It appears that Gaines, the deceased, in his lifetime conveyed the certificates in question to Adams in trust to pay Gaines the income for life and after death for other uses. No powers were reserved, but on the same day on which he received the certificates, Adams, the trustee, indorsed all of the certificates to the donor and redelivered them to

him. It was held that whether this act indicated a desire to insure the receipt of income, or of managing the investments, or to reserve a power to revoke, a valid trust was created.

The cases of *Kelly v. Parker*, decided by the Supreme Court of Illinois in 1899 (Note 28) and *Van Cott v. Prentice*, decided by the Circuit Court of Appeals of New York in 1887 (Note 29) are even more favorable to the reservation of broad powers to the donor than any of the cases above cited and are authority for the proposition that if there is an otherwise valid conveyance to a trustee, the donor may properly reserve full control of the property during his lifetime. Other cases might be cited but it would appear to be unnecessary.

CONCLUSIONS OF THE DENVER COMMITTEE

To recapitulate, it is believed that on the authority of the cases cited the donor may reserve the right during his lifetime to receive the income, to revoke in whole or in part, to modify or supplement, and to direct or consent to sales, investments, or reinvestments. The Denver Committee in its report reached like conclusions but made recommendations in connection therewith which were substantially as follows:

1. As few as possible of the above powers should be incorporated in a trust agreement. The appearance of too many such powers may afford a basis for the contention that the conveyance to the trustee is merely colorable and a reservation of unrestricted control may constitute the agreement a mere agency.

2. Avoid the use of the following words or phrases, which might render the agreement an agency or a testamentary disposition: "bequeath or devise"; "agency or custodianship."

3. Avoid the use of the following phrases, which might be construed to prevent a vesting in interest until the death of the settlor: "at my death the trust shall thereupon terminate"; "if I do not revoke this trust during my lifetime, then upon my death the estate shall be paid to A."

4. Do not fail to use granting words sufficient to vest the legal title in the trustee. Say "sell, assign, and transfer," and do not say "deposi" or "deliver" alone.

5. As a matter of policy and in order to avoid litigation, it is well to have the disposition conform as far as possible with the laws governing the descent and distribution of intestate property.

In summarizing, the committee cautioned against the use of any form of agreement which reserves so many powers or which gives the donor such unrestricted control of the management of the trust as might subject the agreement to the criticism that the donor had in fact parted with nothing by virtue of the conveyance, and that the agreement was for that reason merely colorable or feigned or constituted a mere agency. It was recommended that the agreement should contain at the very most only a reservation of life income, together with power in the donor to revoke, modify, amend, supplement, change the beneficiaries, and add to the trust property, and that the only restriction on the control of the trustee should be that it should make whatever sales and reinvestments the donor might direct; that these reservations should be regarded as an absolute maximum; and that any additional powers or reser-

vations suggested by the customer should be discouraged.

The following quotations from the tentative draft of the Restatement of the Law of Trusts indicate that the views above expressed are in substantial accord with the present opinion of the Committee which prepared the draft:

"If by the terms of the trust an interest passes to the beneficiary during the life of the settlor, the trust is not testamentary merely because the settlor reserves a beneficial life estate nor because he reserves in addition a power to revoke the trust in whole or in part and a power to modify the trust.

"If the settlor reserves not only a beneficial life estate and a power to revoke and modify the trust but also an unlimited power to control the trustee as to the details of the administration of the trust, the intended trust is a testamentary trust." (Note 30)

In conclusion, it is the opinion of the writer, with regard to the effect of reserved powers, that, assuming an otherwise valid trust, any powers may be reserved so long as the trustee is not deprived of all of the duties which are ordinarily incident to the management of a trust estate, but that in every case this general rule should be modified to meet the requirements of the laws of the state in which, if the trust is attacked, its validity will be determined.

NOTES

1. Scott, Trusts and the Statute of Wills, Harvard Law Review for Feb. 1930 at page 535. See also Section 108, Tentative Draft No. 1 of Restatement of the Law of Trusts.
2. Section 63 Tentative Draft No. 1 of Restatement of the Law of Trusts, *supra*.

3. Scott, Trusts and the Statute of Wills, *supra*, page 526, and cases cited; Stimson, Mass. Law Review for June 1927, page 839; Jones v. Clifton, 101 U. S. 225; 26 R. C. L. 1206.

4. 26 R. C. L. 1209.

5. Worthington Adm'r. v. Redkey, et al, 99 N. E. 211; Union Trust Co. v. Hawkins, 167 N. E. 389.

6. "Lastly, somewhat were necessary to be spoken concerning clauses of provisoes, containing power of revocation which since Littleton wrote are crept into voluntarie conveyances, which passe by raising of uses, being executed by the (*) statute of 27 H. 8, and are become verie frequent, and the inheritance of many depended thereupon. As if a man seized of lands in fee, and having issue divers sonnes, by deed indented covenanteth in consideration of fatherly love, and for the advancement of the blood, or upon any other good consideration, to stand seized of three acres of land to the use of himself for life, and after to the use of Thomas his eldest son in taile, and for default of such issue, to the use of his second son in taile, with divers like remainders over; with a proviso that it shall be lawful for the covenantor at any time during his life to revoke any of the said uses. &c. this proviso being coupled with an use, is allowed to be good and not repugnant to the former states. But in case of a feoffment, or other conveyance, whereby the feoffee or grantee, &c. is in by the common law, such a proviso were merely repugnant and void." Coke upon Littleton, page 237.

"It was likewise held, that the uses originally declared may be revoked at any future time, and new uses be declared of the land, provided the grantor reserved to himself such a power at the creation

of the estate. . . . And, in case of such a revocation, the old uses were held instantly to cease, and the new ones to be executed in their stead and this was permitted, partly to indulge the convenience, and partly the caprice of mankind, who (as Lord Bacon observes) (on Uses 316) have always affected to have the disposition of their property revocable in their own time, and irrevocable ever afterwards." 2 Blackstone's Commentaries (Lewis' Ed. 793.)

7. 210 Mass. 50; 87 N. E. 465.
8. 183 Wis. 156; 196 N. W. 829.
9. Trusts and the Statute of Wills, *supra*, page 533.
10. Jones v. Old Colony Trust Co., 251 Mass. 309; 146 N. E. 716.
11. Brown v. Crafts, 98 Maine 40; 56 Atl. 213.
12. Grover v. Clover, Admr. 69 Colo. 72.
13. 278 Pac. 586.
14. 90 Ind. 229
15. Sessions v. Moseley, 4 Cush. 87; Talbot v. Talbot, 32 R. I. 72; 78 Atl. 535.
16. Trubey v. Pease, 240 Ill. 513, 88 N. E. 1005.
17. Darling v. Mattoon State Bank, 189 Wis. 117; 207 N. W. 254.
18. See Talbot v. Talbot, *supra*
19. Talbot v. Talbot, *supra*
20. The Law of Agency, page 27.
- 20a. Restatement of the Law of Trusts, Tentative Draft No. 1, Sec. 1.1
21. Taylor v. Davis, 136 U. S. 334
22. 12 Gray Mass. page 227.
23. 251 Mass. 309; 146 N. E. 716.
24. 204 Iowa 487; 221 N. W. 851
25. 168 N. E. 349
26. 245 Pa. 349; 91 Atl. 634
27. 34 Fed. 2nd, 899
28. 181 Ill. 49; 54 N. E. 615
29. 104 N. Y. 45; 10 N. E. 257
30. Restatement of the Law of Trusts, Tentative Draft No. 1 Sec. 64.

Discussion

JOHN L. J. HART (Colorado National Bank, Denver): I think

that the paper of Mr. King states the view of the committee, of which Mr. King is chairman. Of course, Mr. King did not cite the innumerable authorities, but devoted most of his time to a few cases which have caused the trust officers so much trouble.

HORACE V. CONDIT (First Union Trust & Savings Bank, Chicago): I might ask Mr. King whether or not he thinks it is advisable, in cases in which there might be some doubt, to have the trust instruments executed in accordance with the statute of wills in particular states, or whether he thinks that the trust should not even be attempted in doubtful cases.

MR. KING: In Illinois, I would not have the instrument executed like a will. No court in the United States has ever gone farther than the Supreme Court of the State of Illinois in upholding living trusts. It is my opinion that, with the law settled as it is in that state, you could reserve as many powers to the grantor as you wished, without incurring any danger whatever.

J. M. GARRETT (The Stock Growers National Bank, Cheyenne, Wyoming): Assuming that the property placed in a living trust agreement has been properly transferred and conveyed, and a man at the same time or at a later date executes a will, and in that will there is contained the regular residuary clause, would you consider it necessary to make mention in the residuary clause that all the rest and residue is handled thus and so, with the exception of property previously placed under trust agreement dated thus and so?

MR. KING: The property placed in the living trust, properly transferred and conveyed, need not be referred to in any will.

Modern Facilities for the Systematic Review and Analysis of Trust Investments

By THOMAS J. DUFFY

MANAGER OF THE INVESTMENT ANALYSIS DEPARTMENT OF THE WELLS FARGO
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Address before the Denver Departmental Conference

Mr. Duffy describes various facilities for the analysis of trust investments; all of these facilities have as their one main objective the placing of the indispensable safeguard of expert analysis around security investments from the time a trust is received until it terminates. In this address, Mr. Duffy treats specifically the following topics:

1. Increased demand for investment management
2. Results of new popularity of securities
3. The rise of new problems
4. Modern methods of universal interest
5. General principles applicable to all trust companies
6. Facilities necessary in the trust department
7. Trust investment committee
8. Sub-committee
9. Analytical staff
10. Sources of information
11. Statistical files
12. Submission of accounts and reports—approved list
13. Organized review
14. Account review records
15. Individual bond review
16. Individual stock review
17. Major importance of review by securities
18. Final action.

FOLLOWING the general acceptance of corporate trusteeship and the advent of the modern trust company, which was heralded here by the chartering of the Farmers Fire Insurance and Loan Company by the New York legislature but slightly over one hundred years ago, new demands brought about by new conditions have been successfully met in an ever broadening field.

At the present time one of the most insistent of these demands is for fiduciary investment management.

The field of security investment has broadened and become increasingly complex. As a result, expert supervision is more vital today than ever before. Realizing this, the people are rapidly awakening to the possibilities of trust service in connection with the management of investments,

whether for their own benefit during life or for the protection of their beneficiaries. This is logical, as they see in the trust company an agency whose continuing management is not disturbed or interrupted by death, one that can render the essential quality of supervisory service, and whose judgment, experience, and responsibility constitute safeguards of inestimable value.

RESULTS OF NEW POPULARITY OF SECURITIES

Ever since the World War, when millions of American citizens were introduced to securities through the Liberty Bond campaigns, an ever increasing popularity has been experienced by bonds and stocks as mediums of investment. This has resulted in the public's participating in the financing of business to an extent theretofore not imagined possible.

Many estates are now built with securities almost to the exclusion of other types of investments. Unprecedented expansion of trust business has brought them under our care in increasing number and variety, and the amount of funds to be invested and reinvested has increased proportionately.

It was to be expected, therefore, that securities and their supervision would create new problems and new responsibilities to be met by the trust company.

There is, in fact, no subject of more vital importance to trust companies or of greater interest to trust executives today than that of investment management.

No other function of the trust company has shown the same disposition to outgrow facilities as this one.

What is still more important, the greatest measure of growth is apparently yet to be realized.

In my survey of the facilities and systems of Eastern trust companies for the supervision of trust investments, I found, as might be expected, that they were designed to meet the same investment management problems faced by institutions in California. This was true, regardless of the size of the trust company.

These problems being universal, it would follow that the methods for meeting them are of universal interest. It is incumbent upon us, therefore, to be alive to modern developments in this field, regardless of where they may be in use, that we may consider the profitableness of their adaptation to the purposes of our own institutions.

In reviewing today what might be termed a composite of some of these systems, we will confine ourselves mainly to the common ground of essential principles, and avoid, when possible, consideration of the more or less elaborate refinements, which are necessary only in meeting the requirements of the very largest trust companies. Too, in developing a practical working plan for the smaller organization, based on these principles, simplicity and economy are of major importance.

FACILITIES NECESSARY IN THE TRUST DEPARTMENT

Modern facilities for the systematic review and analysis of trust investments may be considered broadly as providing:

1. A system for bringing matters of trust investment under the su-

pervision of the bank's board of directors

2. Expert security analysis

3. A systematic review of trust investment holdings by accounts and securities

4. Efficient records for these purposes and for establishing, if necessary, proof of diligence in the supervision of investments.

The board of directors, upon which final responsibility for the operation of a trust department rests, must define investment policy, and through a trust investment committee delegated by it, fully supervise all trust investment. Systems for the supervision of trust investments, therefore, must provide for the ultimate submission of all important matters of investment to this committee, which consists ordinarily of members of the board and of the executive personnel.

A sub-committee on trust investments or a trust investment unit, as it is sometimes called, is formed for the purpose of satisfying the need of conserving the time of the trust investment committee and relieving it of all but the most important considerations. This group is composed of members of the operating personnel in intimate touch with the investment problems of individual trusts or whose knowledge of securities under scrutiny is an important contribution to the efficiency of the work in hand. Its function is to digest and organize all matters to be placed before the trust investment committee and to make recommendations as to the final action to be taken.

Expert security analysis is fundamental. Its quality, after all, determines investment ability.

Efficient investment management service, therefore, must be carried out in connection with a specially quali-

fied personnel, which in the case of the larger sized institution is variously known as the security analysis division, investment analysis department, and so forth. In the smaller institution the services of but one investment analyst, or the part time services of a member of the staff who can qualify as an analyst, will often be adequate.

Such experts, keeping closely in touch with general economic conditions, with trends within each industry, and with the status of the individual companies whose security issues are held in the trust accounts, render a service which is the cornerstone upon which modern supervisory services are necessarily built.

The growing investment responsibilities of trust companies have naturally resulted in increased demands for statistical and analytical service.

In the course of discussions following my talk on this same subject at a recent meeting of the Associated Trust Companies of Central California, the question of the necessary qualifications of men selected for the purpose of building up this staff was brought up probably more often than any other.

As is true in the case of any other profession, qualifications do not lend themselves to ready definition. However, experience has shown that the responsibilities cannot be carried out except by men who, in addition to a thorough grounding in accounting and a broad training in practical economics, have a good knowledge of companies and industries. Speaking in a general way, these men should have a good understanding of the principles of finance and investment, and the ability to apply these principles. Too, an investment analyst must, as well as being a student, have

the ability to deal with people and understand their practical, everyday problems.

SOURCES OF INFORMATION

The importance of adequate sources of information to the analysis and supervision of trust investments has grown apace with developments in this field. It is fortunate, indeed, that statistical services have responded to these demands by continually placing more complete information at our command. These services place a wealth of data daily at the disposal of even the smallest trust company which would otherwise not be economically obtainable.

Other valuable sources of information are the underwriters of securities, the various governmental agencies and commissions, the financial publications, and the corporations themselves, which have become more and more liberal in the matter of opening their records to investors.

When the institution is sufficiently large to require a separate analysis division, that department will, of course, embody a complete statistical organization.

In that event, little comment is necessary as the facilities will then include the usual statistical files of alphabetical arrangement by companies, industries, and so forth, with individual folders for each company, debtor, or security in which the institution has a special interest.

In the case of the smaller trust company, simple alphabetical filing units, containing a folder for each corporation or debtor whose securities are held in trust, will serve the purpose very well.

These folders will contain all data

and information coming into the possession of the bank concerning its trust holdings other than that available in the manuals and other statistical services. Too, all correspondence in connection with security analysis and copies of all reports and analyses will be filed here.

SUBMISSION OF ACCOUNTS AND REPORTS—APPROVED LIST

Reports are prepared by the analyst or analysis department on all trust holdings or situations to be passed upon by the trust investment committee and placed before the subcommittee for proper action. Precedence is given to reports on securities of doubtful position or situations concerning which prompt action should be taken. Individual accounts to be passed upon are similarly submitted.

Upon receipt of a new trust, the member of the trust department personnel who is charged with the duty of initiating the work, furnishes the analyst or analysis department with all of the information necessary to the proper administration of the investments.

The information may be briefly outlined for the purpose on a form sometimes known as a "synoptic record," supplemented, if necessary, by an excerpt from the instrument creating the trust, or by a special memorandum. I will treat these data more fully later when we consider the subject of account review records.

An analysis of the account is then made by the analysis division as soon as practicable. While there is no particular form of presentation which can be said to meet requirements better than others, the following is typical of

the contents of the average account analysis:

1. Following the title of the account, a "set up" of the security holdings is made which will indicate:

(a) The amount, description, inventory price, market value, annual income and yield of each security held

(b) The relative proportion, expressed in percentage, of assets invested in bonds and other fixed income securities compared with that invested in common stocks; the percentage invested in any one company, when this appears to be large, should also be given

(c) Relative yields and annual income return of fixed income securities and common stocks and the net income and yield of the entire account

(d) Diversification of industries represented, expressed in percentages

2. A schedule indicating the geographical diversification of the entire list and the diversification of maturities in the bond group

3. A statement, when necessary, concerning such special considerations as the tax status, liquidity requirements, and so forth

4. A brief statement disclosing the position of each security held, coupled with a recommendation for retention or sale. When the position of the security requires closer study, or the situation is complicated, a special analytical report is prepared.

With regard to security analysis, I would emphasize again that the skill of the analyst is the only really important consideration. The form of the analytical report, on the other hand, is relatively unimportant as the report must be fitted to the security rather than the security to the report.

Uniformity in the method of presentation, however, should be striven for in the interests of efficiency. For

example, the material contained in a bond analysis could be presented under the following general headings:

1. Description of issue: This section would show amounts authorized and outstanding, the important provisions of the indenture, the nature of the lien, and so forth.

2. Position of issue in financial plan: This section would indicate the position of the bonds with respect to other capitalization, as well as with regard to all assets and liabilities of the company at the date of the last balance sheet.

3. Position of the company: Under this heading would be set forth a comparative analysis of the earnings statements and balance sheets covering a period of years with especial reference to the funded debt. Such subjects as operating statistics, property, history and business of the company, and its position in the industry would also be treated under this heading.

4. Position of the industry.

5. Comment and opinion.

A complete analysis is also prepared, in the case of new offerings or securities not theretofore approved as purchases for trust investment, for submission to the investment committee. Only securities approved by the trust investment committee are used for the investment of trust funds. This is commonly known as the "approved list."

Immediate cognizance must be taken of the quickly shifting economic trends affecting the fortunes of companies whose issues are held in trust. In meeting this requirement and with an ever increasing number of different kinds of securities coming under their care, trust companies face difficult and complicated problems which only well organized efforts can cope with efficiently.

Such a system for the review of

trust investments is necessarily dual in operation: consisting, first, of the periodical review of trust accounts; and secondly, of the analysis and current review of the individual securities held in these accounts.

ACCOUNT REVIEW RECORDS

Adequate records are necessary for the efficient handling of account reviews and for the purpose of rendering proof of the diligence and prudence exercised by the institution in the management of trust investments. It follows that every step should be of written record.

While here, again, the physical nature of these records may vary widely with the requirements or preferences of different institutions, the underlying principles are the same.

For the present purpose, we will consider one very practical method which is sufficiently simple for use by the average sized trust company inasmuch as most of these records are consolidated into one.

This involves the preparation of a special folder, numerically indexed, for each separate trust account. These folders are preferably of heavy board, legal size, and furnished with a metal clip on each side for binding the contents as is customary in the case of credit files.

Each folder would contain:

1. A schedule of the securities held in each trust, showing the amounts, descriptions, and inventory prices; when this record of holdings is in the custody of the analysis department, it may be kept posted to date by means of advices of "Ins" and "Outs" from the trust department.

2. A brief of the provisions of the trust, relative to the powers of

investment, and such additional information as will indicate investment policies to be followed.

3. The names of trustors, co-executors, co-trustees, beneficiaries, or other parties of interest with whom it is necessary to communicate or consult in matters pertaining to the holdings and before purchase and sale; the preferences, opinions and special instructions (whether originally written or oral) of these parties of interest are also recorded here. In the cases of the trustors and beneficiaries a brief personal history is also of great value.

4. Minutes of action taken by the committee on trust investments, recommendations made for the improvement of the account, a record of changes made and the authority or reason for the continued holding of those securities not approved for trust investment, and so forth.

Each folder, it will be seen, contains all information necessary in properly handling an account. A reviewer has before him at all times a complete history of the trust from an investment standpoint. These data are sufficiently complete to enable any official or member of the staff quickly to take up the work where another left off. All records, too, can be conveniently brought into a committee meeting or referred to at the desk while in conference with the client.

The files containing these folders are located either in the analysis division, when there is one, or in the trust department, depending largely upon physical considerations.

In the case of the smaller institution, the folder may be filed in the same unit and alongside of the correspondence folders for each account.

A diary record of the dates on which reviews of accounts have been made will serve the purpose of bringing them up for review, periodically,

in chronological order. Its importance lies in the fact that regular and timely analysis is thus assured.

INDIVIDUAL BOND REVIEW

All bonds entered in the account records I have just described are listed upon review cards containing, on their face, the name and description of the issue and the dates on which analytical reports were prepared. The reverse side provides for the recording of opinions formed at the date of the last review and a record of committee action. If the number of corporate bonds held is large, these opinions may be more conveniently expressed by letters of the alphabet or in some similar standardized form. Opinion regarding any security held and its desirability as a holding for particular types of accounts, as defined by the investment policies of the bank, is thus readily available upon reference to the file.

The titles of the accounts in which the security is held, as well as the par value or number of shares, may also be posted on the reverse side, thus providing a convenient cross index. However, this is not essential in many cases, as the same information is obtainable from other trust records and may, if necessary, be dispensed with in the interest of economy.

These cards are divisible into three or more classes as follows:

1. Bonds of doubtful position, or of companies likely to be affected to a considerable extent by current changes in industrial, political, and other conditions; these are the weaker holdings which must receive as close attention as the information available will permit.

2. Bonds of a grade stronger than those in the first group, which

should nevertheless be frequently reviewed.

3. Bonds of the greatest strength, which can safely be reviewed less frequently than the first two classes.

The value of segregating bond holdings into these classes is obvious. The frequency of review is thus determined by the necessity for review. By this means efforts may be concentrated upon that group of securities requiring the greatest amount of attention, the weaker holdings.

INDIVIDUAL STOCK REVIEW

With the exception of some of the descriptive matter, a similar card record is kept of all stocks held in trust accounts. Opinions on stocks, however, will not lend themselves so readily to standardization as bonds.

Too, in view of the sensitiveness of stocks as a whole to changing conditions, no end is served in dividing them into classes for purposes of review as is true in the case of bonds. They can, however, be profitably indexed according to the industry represented. Experience has shown, in fact, that weaknesses in holdings, both stocks and bonds, were first detectable in many instances through the recognition of unfavorable developments in the industry. I cannot speak too strongly in favor of the review of all holdings from this important angle, that of the industry.

MAJOR IMPORTANCE OF REVIEW BY SECURITIES

It has been the experience of trust companies that after the dual system of review has been functioning fully for some time, the account review is

confined principally to considering such matters as diversification and the particular requirements of the individual accounts rather than the status of the separate securities held.

The investigation and analysis of the individual bond or stock, especially in cases where a considerable amount of research is necessary, is more efficiently made from the security card record than from the account review. This is true because:

1. The same security is most often held in more than one account, and efficiency requires that the results of an analysis or review be applied to all similar holdings in other trust accounts.

2. The review of the accounts from the folder records often does not bring the securities up for attention at sufficiently frequent intervals; a situation, therefore, could change entirely before a security came up again for review through the folders.

3. The advantages of the segregation of bonds into classes in order to permit the more frequent review of those requiring closest attention are available only through the security review approach.

4. When a bond or stock is held in a number of accounts (which is often the case) several independent investigations of the same security may be unnecessarily made by men handling the account reviews by accounts.

The security card system, too, offers the advantage of providing means for effecting a current review of holdings. In checking information available to us from day to day against these records, immediate notice is taken of new developments affecting trust securities.

The final decisions of the trust investment committee on all matters placed before it by the investment

unit or sub-committee are formally entered in the minutes of its meetings, transcripts of which are then transmitted to the investment unit.

Copies of these transcripts of the minutes are prepared for the records of the analyst or the analysis department, for the trust department, and, of course, for the particular individual in the organization who is charged with the duty of carrying the orders of the committee into execution.

This latter involves the entering of purchase and sale orders, exchanging or depositing securities, writing letters to trustors, co-executors, co-trustees, beneficiaries and other parties of interest whom it is necessary to consult before taking final action, and so forth.

When final action is taken, notations evidencing the fact are entered on the investment sheets contained in the account folders and on the security review cards. Final action may be said to have been taken when the proper persons have been notified of the conclusions reached by the committee, and either its orders fully executed in the case of all accounts for which the bank has any degree of investment responsibility, or it is ascertained that necessary authority for their execution from other parties of interest is not obtainable.

In all cases wherein postponement of final action is indicated, for example, if a bond or stock holding is to be retained for a higher price, an account or a security brought up again for review on a certain future date, rights to subscribe to be exercised on a future date, and so forth, an entry is made on a follow-up card or diary record in order that the matter may receive due attention at the proper time. Notations are also made of

such temporary disposition in the account and security review records.

FACILITIES IN SUMMARY

Back of all of the procedure I have just described will be recognized one main objective: that of placing the indispensable safeguard of expert analysis around security investments from the time a trust is received until it terminates.

To review this procedure once again, we will recall that when a new trust is received, a schedule of the security holdings, together with all information necessary in carrying out the bank's investment responsibilities, is made the basis of a record by accounts. The individual security holdings are then entered on another record to serve the purpose of review by securities.

The account is analyzed as a whole at the time and any recommendations made which are deemed necessary for the improvement of its investment position. While at the most, a brief statement will suffice in the case of the average holding, exhaustive written analyses are prepared in the cases of individual securities or situations requiring closer study.

The findings of these analyses are considered by a committee of the operating personnel, and, with indorsed recommendations, are submitted to a trust investment committee. The account is thus placed under the supervision of the board of directors.

Thereafter purchases for the trust are confined to securities approved by the investment committee, and the account is brought up for review in a systematic manner at regular intervals.

At the same time the individual security holdings are also systemati-

cally reviewed as frequently as their classification indicates is necessary. In checking the cards upon which these securities are recorded against the mass of information available to the analyst from day to day, immediate notice is taken of new developments affecting the holdings.

In these modern facilities for the systematic review and analysis of trust investments, we have the only means for satisfactorily meeting the growing investment management problems of the trust company today. However the particular systems may differ on the surface or in matters of detail, when built upon these principles, they offer a type of investment supervision affording the maximum of safety to the trust, and, with each step a matter of written record, positive protection to the trustee.

Discussion

J. S. KENNEDY (International Trust Company, Denver): What method do you follow in reviewing your real estate loans held in the trust?

MR. DUFFY: Our real estate loans are handled by our real estate department and not by my department, and therefore I am not an authority on the subject; but they are reviewed quite as closely as we review securities. My department knows little or nothing about real estate.

MEMBER (inaudibly): Are not these facilities too costly for many trust companies in many sections of the country?

MR. DUFFY: That is probably true. However it is an essential service.

MR. KENNEDY: Do you have manuals of defunct companies, or

how do you go about finding out about companies which are defunct, that you do not know of at the time?

MR. DUFFY: We have, first of all, a very good manual of obsolete companies. Now, in addition to this, we write to the secretaries of state of the various states in which these companies have been incorporated and through that means we find that we are able to satisfy ourselves in most cases.

MR. THOMPSON (Colorado National Bank, Denver): One of the important things about trust investment is to define the status of the trust when it is opened. Every trust is created with a purpose in mind on the part of the trustor, and if the trust officer will make those facts available for the investment committee, it will be of very great assistance in determining what to invest in, as to maturity, yield, and so forth.

MEMBER (inaudibly): When you note a declining trend in a closely held company and then you sell the stocks, you decrease the market price of the stock.

MR. DUFFY: You do not unless you sell the whole issue. If you hold a considerable block of any issue and you attempt to sell it, obviously you depress the market. That is too broad a question to answer at a meeting like this. I should have to know all of the circumstances.

MR. KENNEDY: With respect to municipal securities here, we find that there are practically no quoted market values. Do you find the same thing true in California, and if so, do

you merely secure nominal quotations for your purposes?

MR. DUFFY: We have a fairly good market for municipals in San Francisco, while it is true that if you are thinking of a small school district with a few hundred thousands, it is quite difficult at times to obtain a quotation. That would be true anywhere. That is about as close as you can get to it.

THE CHAIRMAN: What kind of record do you have to give to the committee members regarding securities held in the trust under discussion? Do you duplicate all of the memoranda in order that each committee member may hold it in his hands or do you depend upon a reading to the committee? How do you get your information to the committee rapidly?

MR. DUFFY: That would depend entirely upon circumstances of the particular case.

THE CHAIRMAN: Suppose you had fifteen or twenty securities in a particular account, upon which you, in your files, had a more or less complete report as to each item made within the last few days, and you had also in your files a brief abstract of trust giving the essential points regarding investments eligible and the purpose of the trust, and the particular point of view of the beneficiary. Let us also assume that your committee has not been informed on these points before.

MR. DUFFY: All of these records are kept in this account folder. We pass the folder from hand to hand.

Trust Department Administration in City Branches

By ANDREW WILSON, JR.

ASSISTANT VICE PRESIDENT OF THE BANK OF MANHATTAN TRUST COMPANY,
NEW YORK, NEW YORK

Address before the Denver Departmental Conference

Mr. Wilson describes the organization of his bank, the Bank of Manhattan Trust Company. The city branches of this bank cover approximately twenty-five miles.

While there may be certain types of corporate trust business which, for reasons of local convenience, may be successfully administered in the branch offices, where established trust organizations are maintained, the more important and desirable trusteeships and other corporate appointments naturally originate in or gravitate to the main office on Wall Street. The policy of the bank is to handle all corporate trust business at the Wall Street office regardless of where it may originate.

To provide the intimate and personal contacts which are essential for the successful administration of personal trusts, the territory served by the various branches of the bank has been divided geographically into divisions.

The divisional trust officer passes upon the numerous incidental questions which arise in the settlement of every estate, but he is restricted in the field of investments. The investment manager and the investment committee make recommendations relative to investments; a committee of senior officers reconsiders and acts upon these recommendations; and they are passed upon finally by the trust committee of the board of directors.

THE problem of organizing a trust department so that it will operate efficiently in a branch banking system in the City of New York differs, perhaps, in certain respects from the problem which would be presented in most large cities.

The island of Manhattan, with which many of you are well acquainted, is merely the heart of a vast and ever expanding territory, all of which is included in the Greater City of New York. In addition to New York County (Manhattan Island) the Counties of Kings, Bronx,

Queens, and Richmond all lie within the city limits. Bronx County lies to the north of Manhattan, separated from it by the Harlem River, while Kings and Queens Counties are situated across the East River on Long Island, and Richmond County, which covers the whole of Staten Island at the lower end of the harbor, can be reached only by boat from the other boroughs.

While these various political units have been welded together into the Greater City of New York under one municipal government, they are,

nevertheless, in many respects, independent communities, each having its own center of county government, each distinguished by certain local traditions and possessed of local atmosphere, each with its own system of courts and court houses, and each affected by conditions and restrictions peculiar to it.

The main office of the Bank of Manhattan Trust Company is located at 40 Wall Street, at the lower end of Manhattan Island, in the very heart of the financial center. Throughout the Greater City of New York, some sixty-seven branches are now in operation, each branch in the charge of a manager chosen not alone because of his ability and familiarity with banking and business procedure, but also because of his familiarity with the local conditions and atmosphere to be found in the community served by his branch. These branches are distributed over an area of approximately two hundred and fifty square miles, and serve a population of approximately six million people. The branch at Rockaway Park is approximately twenty-five miles from the branch at Dyckman Street and Sherman Avenue in upper Manhattan.

ALL CORPORATE TRUST BUSINESS AT MAIN OFFICE

With its main office on Wall Street, in the very heart of the financial district, the business of obtaining and discharging various types of corporate trust business differs very little from that which confronts any metropolitan trust company. While there may be certain types of corporate trust business which, for reasons of local convenience, may be successfully

administered in the branch offices, where established trust organizations are maintained, the more important and desirable trusteeships and other corporate appointments naturally originate in or gravitate to the main office on Wall Street. The policy of the bank is to handle all corporate trust business at the Wall Street office, regardless of where it may originate.

The most perplexing problems in the organization and operation of such a trust department arise primarily in the field of personal trusts, and have to do with the solicitation of wills, estates, and deeds of trust, and the efficient and sympathetic administration of these types of trust business.

Obviously, in organizing a trust department to function properly in such a system, too much standardization must be avoided and the peculiar requirements of given localities must be recognized. The daily activities of a trust department functioning at Jamaica, Long Island, may be widely different from those at the main office at 40 Wall Street, and equally different from the interests and requirements of the upper Bronx.

Naturally, the largest and most complete organization is at the main office of the bank where, under the immediate supervision of the vice president in charge, all of the trust business, personal and corporate, which originates in the division directly controlled by that office is administered. At the same time this office is equipped to render assistance and advice to any of the trust officers in charge of the other divisions upon request. The general policies under which the entire department is administered are promulgated at the

main office, where the trust committee of the board of directors meets at frequent stated intervals.

GEOGRAPHICAL DIVISION OF TERRITORY

To provide the intimate and personal contacts which are essential for the successful administration of personal trusts, the territory served by the various branches of the bank has been divided geographically into divisions. In the main this arrangement differs only slightly from the division of the territory by the bank for purposes of general administration. At the central dominant branch in each of these divisions, a trust department unit is maintained under the direction of a man specially trained in the work of administering trusts. These divisional trust officers in turn work closely with the managers of the various branches located in their divisions. The branch managers themselves will acquire by training and experience familiarity with many phases of the personal trust business sufficient to enable them to discuss these matters intelligently with the customers of the bank. Each branch manager is equipped with a comprehensive manual in which the various services offered by the trust department are described in detail and to which he may refer for specific information in the field of trust work.

Beyond training the branch managers to engage intelligently in discussions, no attempt is made to conduct or administer trust business in the various subordinate branch offices. When a trust or a will goes into operation, the business is administered by the trust department at the divisional center most conveniently lo-

cated. Each of these divisional offices is manned and equipped to operate independently in the handling of its business and is encouraged to do so. Each is a complete unit where estates are received and administered, securities and cash are kept, personal contact with beneficiaries is maintained, and which is expected and encouraged to operate independently. The executives in charge of the department appreciate fully the importance of developing self reliance on the part of the trust officers in charge of the work in the various divisions and prefer to encourage them to act upon their own initiative and to arrive at their own decisions in so far as they are capable of doing so.

THE DIVISIONAL TRUST OFFICER

It is equally important to leave with the divisional trust officer discretion to pass upon the numerous incidental questions which will arise in the settlement of every estate. This not only contributes to the education and development of the officer himself, but it gives him an added dignity in the eyes of the persons with whom he must deal. He cannot do effective work if at vital moments he must suspend all operations until he obtains the approval of the main office. In some instances this will be necessary, but it is to be avoided as much as possible both for the sake of the divisional trust officers and in the interests of new business development.

In the field of investments alone is the independence of the divisional trust officer restricted. But even the chief administration officer at the main office is subject to the same restrictions in this respect. The investment

of all trust funds is centralized in and directed from the main office, where the entire time of an investment manager, with a corps of assistants trained in the selection and handling of all types of securities, and with statistical facilities readily available, is devoted exclusively to the investment problems of the various estates, and to the review, study and analysis of securities held in trust.

THE INVESTMENT MANAGER

The post of investment manager in our organization is regarded as so important that it is filled by an assistant vice president.

The investment manager maintains a complete record of all investment holdings, as well as a copy of each instrument of trust, so that he may at all times be familiar with the character and propriety of the investments, and may give consideration to any announcement, change, or trend in the business or financial world by which securities held in trust in any division may be affected.

The trust officer in charge of administration in any division is required to advise the investment manager when funds will be available for investment in any given estate or when he believes that any change in investments is advisable, furnishing whatever information is appropriate and making a recommendation if he wishes to do so.

THE INVESTMENT COMMITTEE

The investment committee of the trust department meets frequently at stated intervals. Each divisional trust officer is a member of this committee as well as the investment manager, the

vice president in charge of the department, and his assistant. The investment manager submits his recommendations for investment changes in each estate, together with an analysis of the present holdings, and the salient facts affecting the proposed change. The divisional officer familiar with the estate is present to furnish any pertinent information as to the types of people involved and the peculiar problem presented. Each recommendation is separately considered, discussed, and passed upon carefully. The following day the recommendations of this committee are reconsidered, modified, and acted upon by a committee of senior officers selected for their peculiar aptitude in the field of securities. These decisions are then acted upon by the staff of the investment manager. Ultimately a complete record of their recommendations is passed upon by the trust committee of the board of directors, which reserves the right at any time to revise or revoke the action previously taken if the interests of the estate require it in their judgment.

In the selection of real estate mortgages the plan of operation differs slightly, in that the recommendations of the mortgage manager are passed upon by one committee, which functions in a manner quite similar to the operations of the mortgage committees of large savings banks.

The staff of the securities department is continually occupied with the analysis and revision of the investment holdings of the department, which are indexed and listed so that the aggregate holdings of any single security or class of securities may be readily determined.

You will see that in this manner.

the investments of each estate are subject to a double safeguard. The divisional trust officer directly in charge of the estate is watching his investments to conserve and improve them, having in mind the peculiar personal needs of the beneficiaries, while the investment manager is studying his investment list constantly, with an eye to income, maturities, redemption prices, exchanges and market trends.

Let no one assume from my presence here that the Bank of Manhattan Trust Company believes that it has found the ultimate solution for all phases of this problem. Time and experience will show us how to improve and refine these methods.

I am fully aware that in other trust companies different methods are being tried, no doubt with a fair degree of success.

I understand that in at least one institution in New York City which operates a number of branches, the divisional offices are permitted to purchase securities direct, with the qualification, however, that any securities purchased must be chosen from a selected or approved list, which is prepared and distributed at the main office, with frequent announcements of the price brackets within which purchases must be made. We believe, however, that under this approved list system, they are in grave danger of forfeiting the advantage to be gained by the skilful analysis of

investment lists by the investment manager and the painstaking consideration of the problems of each estate by the various committees.

I am informed that another metropolitan trust company, which is developing a considerable number of branch banks scattered over a wide area, still clings to the belief that it can render effective trust service by concentrating the administration of all of its estates at the main office. While this may be the most economical method of operation, having in mind only the items of salaries and overhead, we are convinced that the highest quality of trust service will not be rendered under a plan which ignores the factors of distance and local atmosphere and which places upon beneficiaries a burden of inconvenience and annoyance which they will not accept gracefully and to which they will not look back with any feeling of warmth or gratitude.

If in expanding our trust department, we lose sight of the true test of fiduciary service, that of quality, and follow the false gods of quantity production and standardization, then we may well be concerned over the future, but if we cling tenaciously to our determination to render nothing but the highest quality of unselfish, disinterested service, content with a reasonable recompense, the future of branch banking institutions in the fiduciary field will indeed be brilliant.

Trust Development and Administration in Statewide Branch Banking Institutions

By WILLIAM W. JACKA

ASSISTANT VICE PRESIDENT OF THE BANK OF ITALY NATIONAL TRUST &
SAVINGS ASSOCIATION, SAN JOSE, CALIFORNIA
Address before the Denver Departmental Conference

The difficult and delicate problems of trust development and administration become vastly more complicated as an institution takes unto itself branches; and when these branches number 293, as they do in the Bank of Italy National Trust & Savings Association, it is obvious that uniform ideals and practices are essential.

Just how, in Mr. Jacka's own great company, the head office and the branches have been wrought into a smoothly running mechanism for the management of trusts, operating with maximum efficiency, he tells the reader in this comprehensive article.

Now that Congress is debating seriously the sanction of branch banking for national banks throughout the country, the questions considered by Mr. Jacka are especially valuable and timely.

DURING the present session of the Congress of the United States of America, a question of more than minor importance to the banking fraternity and to economic America has been the center of exhaustive committee examination. I refer to the matter of extending to national banks the privilege of acquiring, opening and maintaining branches, either within our national boundaries or within smaller geographical limitations.

We have seen our local industries become parts of nationwide organizations, and I believe that the time is not far distant when we may expect to see our banking system follow suit, lest it fail to meet the natural demands that are being made upon it.

Regardless, however, of whether or not nationwide branch banking is permitted, we have branch banking in many of our states at the present time, and consequently many of us in the trust business are facing problems connected therewith.

As on all sides we hear of increased branch banking, we also hear from every section of this country of the ever increasing tide of trust business. We all know that one of the principal reasons for this tremendous increase in trust business is the extensive development program that is being carried on by the banks throughout the country.

A development program in a unit bank may be carried on with comparative ease, because of the fact that

the workers connected with the unit bank are all housed within four walls and can receive constant supervision from the executive head of the trust department.

When a trust development program is contemplated in a branch banking institution, I believe that the first problem is the education of the several banking staffs. Our advertising will be of little avail if the subject matter involved cannot be intelligently discussed by the contact men and women in the banking departments of the various branches. Education of the staffs—how can it best be carried out?

EDUCATION OF BANKING STAFFS

If you will pardon mention of my own institution, the Bank of Italy National Trust & Savings Association, I shall attempt to sketch for you briefly the manner in which we have handled the problem of education up to the present time.

First, we divided the State of California into several geographical parts and determined upon a central point as the educational headquarters for each division. Of course, our larger cities constituted divisions in themselves, since the study groups, we determined, should not be too large. We believe that they should be limited to, say, 100.

We then circularized all the officers and employees in each division and advised them that once a week, beginning on a certain date, a so-called question and answer course covering our trust services would be given at the central city. Of course, we chose the evening as the logical time for these meetings. We pointed out the value of our course, both as pro-

moting personal improvement and as increasing our bank's earnings. Each officer and employee was given a return postal to be mailed to our trust officer, indicating whether or not he or she would participate in the course. In this manner we obtained a birds-eye view, before we started, of just about what our success was going to be.

The results of this preliminary campaign were most gratifying, and we had no difficulty in interesting large groups. We now find those who have not been in a position to take the course up to the present time asking us to repeat it in various of our districts, and this in spite of the fact that it has already been repeated in most of the districts.

And now for the course, which requires six weeks, one evening a week:

It had been our experience that a lecture on a subject was most unsatisfactorily digested, and we determined upon a new plan. First, we divided the scope of the trust business into various subjects; for example:

- Introductory questions
- Wills
- Trusts
- Administration of wills and trusts
- Escrows
- Subdivision trusts
- Solicitation
- Trust service for corporations.

We then formulated and mimeographed some of the questions that arise in the minds of laymen and that are likely to be asked of our banking department men and women in relation to the various topics. We printed the questions and left space between them for concise answers.

Our course was then carried on by our various assistant trust officers

from head office, who stood before the groups and asked the questions and then answered them in clear, understandable English, refraining from technicalities as far as possible. We announced at the beginning of the course that questions from the class would be welcomed, but we requested that the questions be confined to the subject matter under discussion at the moment, thus avoiding repetition and the possibility of a loss of continuity of thought.

We did not hope to make trust men and women of the members of our classes, but we did intend to give them sufficient information to enable them to understand and intelligently discuss in an informal manner our advertising material and our service. After the course was completed, they knew the advantages of corporate trust service. They knew some of the burdens and responsibilities of an executor and trustee. They knew something of our accounting system and the need for an orderly accounting system in any fiduciary matter. And, last but not least by any means, they were able to recognize a prospect when he came within their view thereafter.

We have a good-sized library in our institution, and we have made certain that it contains books and periodicals on various phases of trust work. We always include some of this material in our library bulletin, which is published weekly, so that we may keep our staff "trust minded."

After carrying on this educational program and acquainting your co-workers in the banking departments with some of the ramifications of the trust business, you can safely proceed to compile mailing lists at your branches in the same manner that you

would in the unit organization, and may proceed with your "propaganda" program, if you will excuse the expression.

I believe that all advertising material should emanate from the head office of the trust department, so that it may be uniform throughout the territories served. I also believe that every piece of material should be checked most carefully by the executive head of the department, as well as by the attorneys for the bank, to prevent any possible lack of harmony with the bank's policy or with the law.

EARLY DEVELOPMENT

During the early history of our trust department we did very little in the way of carrying on a truly statewide trust organization, as we interpret the term statewide. In our commercial and savings departments, surely, we were contacting and serving the rural communities throughout our state and were giving them truly metropolitan banking service, but the general education of our banking department staffs had not been carried on to a great enough degree to take advantage of the trust business lying all about us.

Gradually, however, as we spread our educational program among the officers and employees of our statewide staff, our efforts began to bear fruit in the way of actual business at our branches. This called for the establishment of small trust departments in a few of the larger centers of population.

We established at our head office a so-called branches division, whose duty it was to lead these smaller offices along prescribed lines of oper-

ation. At the very beginning, it was recognized by our institution that the actual administration of trusts at branches in the smaller communities had a most satisfactory reaction in securing new business, as well as in assuring satisfied customers. If the probate of John Brown's estate was carried on at the branch in the city of his residence, the entire community watched with great interest the result of our efforts.

As our general advertising material extolled the corporate executor, it was quite natural that at least an occasional client would nominate us in his will. When you take into consideration the number of branches that we operate (293 in 166 cities), you can easily see that an occasional nomination in each of the branches resulted in an enormous total. It has always been the practice of my institution to retain the attorney who represented the client during his lifetime, rather than a chosen attorney in each community. Thus, we were dealing with practically as many different attorneys as we had estates on our books. Here, again, education was necessary, and very diplomatic education it had to be, lest we be considered presumptuous when we attempted to point out the differences between the estate forms and practices that had existed when individuals acted in the various fiduciary capacities and those followed by a corporate fiduciary.

Perhaps the branch manager was a highly educated man, thoroughly versed in banking practices, but knowing little or nothing about estate work. His problems in connection with his estates necessarily had to be referred to the branches division at head office, with attendant loss of time and utter loss of local color in so far as the

branches division was concerned. Naturally, the problem grew more involved every day, and, no matter how large the department became, the loss of personal contact was always felt.

The only natural solution was the establishment of so-called trust districts, with a supervising, well trained trust man in each district. Accordingly, the state was divided into fourteen districts, and a man trained at head office was put in charge of each of the districts, with his office in the largest city in the district. Around this supervisor was built a staff, varying in size according to the already existing business, which staff was increased as need demanded. This was, of course, an expensive move, and the first thing to be accomplished by the district trust officer was the building of the business to justify the establishment of the district office.

It has been our aim to make each branch self-sustaining. To the district are charged salaries, rent, stationery, telephone service, traveling costs, and all other expense items that would necessarily have to be borne by an independent organization. The administration cost at head office is also assessed against the districts, with the deposits ratio as the means of determining the pro rata allocation. This total we divide among the branches in the district, again using the deposits ratio. We have found that red ink in the earnings report of a branch has a distinctly awakening effect, and that black ink gives much satisfaction. In a few of our branches the earnings from the trust operations this year will exceed the earnings from the banking operations.

It was generally considered that the surface had not been scratched,

in so far as trust business was concerned, and that it was the district trust officer's job at least to begin to pierce this surface. We from the rural communities and smaller cities know of the close personal relationship that exists between the depositors and the bank employees. Naturally, therefore, we should proceed through this most logical channel in the building of our business.

Our educational work was carried on unceasingly with our banking staffs. They all made their own wills, under our supervision, naming the bank as executor, and, in some instances, as testamentary trustee, and many of them created life insurance trusts. They all became "will minded" and "trust minded." They recognized in their customer a prospect for the trust department, and all became salesmen for that department.

We have found that even after instituting this organization, however, we must still continue with a driving force. Periodical calls at each branch at intervals of not more than two weeks, for the sole purpose of contacting prospects developed by our branch staffs, must be made in order to keep this spirit glowing.

We have found that by maintaining a friendly rivalry between the districts and even between the different branches in the same district, we have accomplished some most satisfactory results. It is our practice, whenever possible, if our client has made his will, to have him file it in his branch for safekeeping.

When a will is filed at one of our branches, a card is made in triplicate, showing the testator's name, the branch at which the will is filed, the date of filing, the officer filing the will, the employee responsible for the

business, the approximate net worth of the testator, and the name of the testator's attorney, if he has one. This card also has a blank for insertion of date of withdrawal and for receipt by testator, should the will later be withdrawn. The original of this card remains at the branch where the will is filed; the first copy goes to the head office; and the triplicate copy goes to the district office.

Thus, we know pretty well how we stand as to the potential business at the branch, and we can plan the development of personnel for administrative purposes accordingly.

A very interesting ratio has been worked out in this connection: the ratio of wills on file at each branch to the number of commercial depositors at that branch. This ratio is sent to the several branches, and you would be surprised to know how the first ten places on the list for the branches throughout the state are coveted. The standing is made known on June 30 and December 31. On December 31 last, one of our smaller branches with 650 commercial accounts had over 200 wills on file. This branch, which, by the way, I am happy to say, is in my district (the San Jose District) led the state in this ratio. I impressed the staff at this branch that they must not now rest content, lest one of the other branches should take the lead away from them. All of the employees are now determined that this shall not happen, and I won't even venture a guess as to what the percentage will be by the end of June 1930. You may rest assured, however, that there will be very few worth-while intestate cases in that vicinity as time goes on. We have found that a great deal more can be accomplished in this manner

than by approaching our new business problem with a demand for results.

Wills are now being filed with our institution, taking all of the branches into consideration, at the rate of over 500 a month. Living trusts and life insurance trusts are being placed on our books at the rate of 100 a month. And still we maintain that we haven't begun to reach the business available.

OPERATIONS

Now we shall consider (and, I am afraid, briefly) the subject of operations. Here, perhaps, we have a much larger problem than in the obtaining of new business.

As I stated, the actual administration of business is carried on at each branch, with the exception of the small branches in our larger cities, where more than one branch operates, in which cases the business developed at all branches in that city is administered at one branch, the smaller branch receiving 25% of the fees collected, for having originated the business.

The actual securities are kept under double custody at the branch at which the estate or trust is being administered. Especially in the case of our private trusts or living trusts, it has been our experience that the trustor is much happier if he can go to the branch occasionally and actually see his securities.

Unless the business warrants a complete subsidiary trust department or a full-time assistant trust officer, the actual administration work is done by the branch manager or assistant manager, the general bookkeeper attending to the accounting end. Necessarily, therefore, the branch manager has been more highly trained in the

operations end of the business than has the balance of his staff. Almost continuously we are conducting courses at our head office. These courses last for a period of two weeks at a time, and the officers at head office act as instructors. A group of branch managers, ordinarily twenty-five, are asked in, and for two weeks they actually go to school, morning, afternoon, and evening. Perhaps after a short time these same men are asked to attend an advanced class, to the end that they may become fully familiar with the various ramifications of our profession.

At these "institutes," as we call them, are demonstrated our practices and our forms. Here the reasons for our rules are explained. Transactions are followed from the initiation to the consummation. We have found that the institutes have resulted, not only in a clearer conception of the business by those in attendance, but also in a more sympathetic understanding of the demands of head office and the district offices for reports and for uniformity of practice.

Naturally, our accounting system, policy program, personnel questions, and investment practice must be governed by head office.

We operate under a system of numbered circulars and numbered operating letters, so that all detail work is carried on in a uniform manner at all of the branches. All of our forms are numbered, so that all the branches "speak the same language."

Diaries, maturity ticklers, copies of all papers in estates, copies of all private trusts, copies of all escrow instructions, and securities lists are kept at the district office, as well as at each branch, so that the district supervisor and his staff may know, check, and

follow what is transpiring and may anticipate sufficiently in advance what must or should be done. These requirements are all set forth in our numbered circulars.

Each branch operates a trust department general ledger, and at the end of each month, as well as whenever a "call report" is asked for by the state or national authorities, a financial statement is rendered to head office, where the statements are all consolidated into one so-called consolidated statement. This statement, of course, reflects the condition of the entire state at a given date.

Copies of certain of the important papers and copies of all private trusts are also kept at head office. A diary of expected papers is carried at head office, as well as at each district office, so that the status of each case is known at all times. Head office is thus in a position to check the district office in any necessary detail.

INVESTMENTS

All investments are made at head office through a directors' investment committee. At the end of each week every branch in each district sends to its district office a list of uninvested cash balances in each of its trusts and estates. This list is closely scrutinized by the district supervisor, who passes it on to head office, with any suggestions he may deem it advisable to make as to investments, with reasons for those suggestions. These lists are reviewed weekly by a subsidiary investment committee, composed of the officers of the trust department at head office. This committee, conducted along parliamentary lines, passes on its suggestions to the directors' investment committee, whose

members either approve or veto the action taken. We believe that this plan enables the district supervisor to put into effect his personal knowledge of each case, but the investment is actually made by a committee with specialized knowledge and with no community prejudices. At the end of each month, each branch sends to its district office a list of securities holdings in various trusts and estates, and these lists, after they have been examined and the contents posted to control investment cards, are passed on to head office, where still another control, used by the analysis department, is set up from them for periodic review and for analytical purposes.

As I have stated, all accounting and practice is uniform throughout the state, by reason of circulars and operating letters from head office. Sometimes, however, it is possible that two persons will differently interpret a given circular. To prevent this and to assure uniform practice, each district office has on its staff an assistant trust examiner, whose duty it is continually to audit the various branches in his district. These examiners are trained at head office and are more than accountants, since they must also audit practices, legal and otherwise.

In order that these examiners may be checked in their auditing, once a year each examiner is called to another district, where he carries on an examination of another examiner's work. And then, lest there still be a slip-up, occasionally a complete inspection and audit is made by the inspection department of our general bank. Of course, in addition to this we have the regular examinations by the state and national banking departments.

We therefore believe that we are almost "fool proof."

As I stated before, the actual administration work is carried on at the branch where the business originated, except in the larger cities with numerous branches. There the work is concentrated, usually, at the largest branch, where a sub-district office is maintained, manned by a full-time trust force.

This administration work is directly under the eye of the district supervisor. All correspondence regarding administrative problems is addressed to the district office by the branches, thus removing the possibility of considerable duplication of effort. In so far as the branches are concerned, their district office is their head office.

The districts are so constituted geographically that it is possible for the supervisor to reach the most distant point in his district within three hours, thus insuring expeditious handling of problems, and personal contact where it is necessary.

Practically all of our documents are prepared at head office and are submitted to the district offices for careful checking before they go to the branches, thus assuring standard legal practice and form throughout the state. Documents in various estates, prepared by the attorneys for the estates, are all submitted to the district offices, thus constituting a check against possible irregularities due to lack of knowledge of corporate fiduciary practice and law. In the language of Amos 'n Andy ours is a system of "check and double check."

Discussion

CLARENCE P. ROWLAND (Corn

Exchange National Bank & Trust Company, Philadelphia): Mr. Jacka stated that in his territory, they do the administrative work in the branch itself. I should like to know if you do that, Mr. Wilson?

MR. WILSON: We find that because of the relative proximity of the branches to the center, it is just as easy for us to refer the beneficiary to the nearest center, which may be a matter of a few miles or less; and we have not more than half a dozen divisional centers at which complete administrative work is done.

MR. ROWLAND: Do you have difficulty in finding the qualified men to take care of your divisional work?

MR. WILSON: Good men are always hard to find. Some of them come up through the ranks and sometimes we get a man from outside who has good qualifications.

W. R. HENMAN (Grand Valley National, Grand Junction, Colorado): Do you feel that under the system which your bank operates, the quality of service would be as high as is ordinarily rendered by an institution that does not operate a branch or branches?

MR. WILSON: Yes, I do, so long as we are willing to spend the money to develop the branch and to have the higher type of man available. In fact, I have an idea that perhaps when a bank is strong enough along those lines, it can afford to pay outstanding men, and more of them, than a single unit bank may be able to do.

JOHN J. WATKINS (First Trust & Deposit Company, Syracuse): What is the policy of your institution in regard to sales?

MR. WILSON: We have an iron-clad rule that we buy no securities in which the bank has the slightest inter-

est, such as underwriting, or anything of that kind. We maintain our trust department in a purely disinterested condition.

MR. HENMAN: Did I understand, Mr. Jacka, that the entire administrative work is performed at the divisional headquarters?

MR. JACKA: No, it is carried on entirely at the branch under the supervision of the divisional headquarters. The actual contact with the client, the actual rental of property, the actual operation of business, is carried on by the branch at which the trust is being carried on, under the supervision of the district trust office, as I have explained.

MR. HENMAN: May I ask just what that supervision is: is it a day by day contact or just a weekly or periodical report?

MR. JACKA: There is contact on an average of once a week or as often as is necessary. We are on the other end of the telephone line; we can get to the farthest branch in three hours. If it is something for which advice must be given immediately, of course it must be over the telephone. But ordinarily you do not have to make a decision in the carrying on of an estate, in a shorter period of time than three hours. I might say that when the district supervisor leaves his home in the morning for a specified point, he never knows where he is going to be before night comes, because calls are all directed into the district office and the telephone operator is instructed in the morning just exactly where he is going to be and what hours he will be there. Should a long distance call come, the supervisor is reached without loss of time or without the expense of unnecessary long distance calls.

MRS. KATHRYN BERKLEY (Fidelity National Bank & Trust Company, Kansas City, Missouri): It seems to me that your plans are worked out wonderfully as to detail. As to operating costs, what is your profit ratio to your operating cost now?

MR. JACKA: That is a question I am sorry I cannot answer. We have started a system that will undoubtedly answer that question within another month, and it is being done in this way, that on each expense tag that is sent in by any one in the district, we have a rubber stamp which shows the percentage of the time used on that particular expense item for promotion of new business; the percentage of time that is used for supervisor's work; the percentage that is used on trusts, escrows, and so forth; and at the end of each month, the supervisor is required to send to the head office, a detailed statement of each employee, the percentage of time used by each employee for each service performed, to the end that the necessary division of salaries may be made. And in that way, we believe that now we are going to be able to determine just exactly how much it is costing us, or approximately so, to write new business, so that we may determine the unit cost for the new business; just how much of the time is going into trusts which lose money or those which make money; the same with escrows. At the present time, I can tell you that, in the aggregate, we are making money and we are putting a great deal of potential business on our books.

MR. NEIBURG (Denver National Bank, Denver:.) What is the secret you have of training your employees, in making them potential salesmen?

We thought we had been getting along reasonably well until we heard your figure.

MR. JACKA: I can tell you just how we proceed in my particular district. I neglected to tell you in my paper that my district was the first one that was formed in the State of California. Mine was an experiment. I realized I had a big job. I went into the district and called a meeting. I told the employees I was down there absolutely at their mercy. I asked them for their cooperation, and I suggested that each one draw his will. I told them to save their personal problems until I arrived. It

involved my staying up nights to take care of their personal problems, but I was perfectly willing to do that; however, I asked in return that they endeavor to interest a client in the business. It was very seldom that I called that they did not have some prospect for me.

KENNETH C. HARNDEN (First National Bank, Altoona, Pennsylvania): In creating an estate, do you have a minimum amount at which you will accept the business?

MR. JACKA: We accept business no matter how small it is. We seek only good business. We do not turn down any business at all.

INDEX

AUDITS AND ACCOUNTING

Auditing Department Organization and Manual of Procedure	William C. Tompkins	5
Discussion		10
Trust Department Auditing	Russell F. Thomes	14
Discussion		19
Acceptance Accounting and Auditing	Christian Djorup	25
Discussion		34
Fundamentals of Audits and Accounting	Joel B. Fort, Jr.	37
Discussion		40
Daily Adjustment Accrual Accounting	Ralph L. Watters	43
Discussion		47
Departmental and Per-Item Cost Accounting	Alfred J. Blasco	50
Discussion		60
Budgetary Control	E. J. Novy	65
Discussion		70
Ratio Analysis and Control of Resources and Liabilities	W. E. Paul	74
Discussion		88
Valuation of Bank Stock in Consolidations	Christian Djorup	91
Discussion		97
Audit and Control of Non-Cash Collections	E. C. Lindman	101
Discussion		105
The Auditor As Watch Dog for and As Advisor to the Chief Executive	Harry C. Schaefer	108
Discussion		112
Money Making and Saving Tips for Banks	W. A. Nieweg	115
Discussion		119

BANK ADMINISTRATION

Real Estate Loans	A. C. Tosch	129
Discussion		134
A Sound Loan Policy	Alfred E. Roberts	138
Discussion		142
Farmer Loans	Thomas G. Wilson	143
Discussion		150
Industrial Loans	Joseph E. Birnie	154
Discussion		163
The Credit Department and Credit Bureaus	Robert D. Kerr	165
Discussion		169
A Simplified Cost System for Banks	R. C. Huelsman	172
Discussion		186
Interest on Accounts—Commercial and Savings	A. C. Burchett	190
Discussion		195
Chain Store and Other Branch Accounts	Clark C. Mitchell	199
Discussion		207
Responsibility of Directors	William H. Lindsay	212
Personnel and Accounting Safeguards	A. R. Lemm	217
Discussion		222
Management and Accounting Control of Branch and Group Banks	E. V. Krick	226
Discussion		237

BUSINESS DEVELOPMENT AND ADVERTISING

How to Find and Approach Corporate Depositors	Joe Martyn Turner	243
Discussion		245
Sales Arguments for Correspondent Bank Prospects	Charles N. Evans	247
Discussion		254
Selling Personal Checking Accounts.....	Kit Carson	255
Discussion		262
Filing Systems for New Business Use.....	Earl V. Newton	268
Discussion		275
How to Select Trust Prospects.....	J. M. Easton	278
Discussion		282
Advertising and Solicitation.....	H. L. Dunham	286
Discussion		296
Life Insurance Trust Development.....	Fred W. Steiner	299
Discussion		304
The "O—O" of Trust Development.....	R. S. Racey	306
Discussion		311
How to Write Effective Copy.....	Frank Fuchs	315
Discussion		321
How to Build an Advertising Budget for a Bank...	Preston E. Reed	324
Discussion		330
Modern Art in Advertising.....	John A. Reynolds	333
The Problem of Layout in the Modern Newspaper...	J. K. Waibel	337
Discussion		342

CREDITS

The Modern Credit Attitude.....	Charles C. Kimball	345
Discussion		350
The Property Statement As an Aid in Solving Customers' Problems	Alexander Wall	356
Handling Credits in a Group Banking System....	George S. Eccles	371
Discussion		395
Financing Agricultural and Live Stock Credits..	George B. Harrison	399
Discussion		403
Reciprocal Relations Involving the Credit Department of a Commercial Bank.....	E. L. Blaine, Jr.	405
Discussion		412
The Commercial Sales Manager.....	L. P. Reed	417
The Commercial Credit Man.....	Charles R. Knight	420
The Financial Credit Man.....	Eugene McElvaney	423
Discussion		431

DEPOSIT FUNCTIONS

Bankers' Deposits and Facilities of Reserve City Banks	C. B. Anderson	441
Discussion		446
Federal Reserve Facilities for Member Banks.....	J. E. Olson	449
Discussion		451
Transit and Collection Problems of a Group or Branch Banking System	C. I. Canfield	455
Discussion		464

The Personal Touch in Handling Collections.....	E. L. Uhlik	467
Discussion		473
A Teller's Responsibilities.....	Charles E. Shepard	477
Discussion		481
Interior Clearings.....	Frank E. Cobun	483
Discussion		492
Some Clearing Problems.....	George L. Greenup	495
Discussion		497
Air Mail.....	Russell LeBrock	503
Discussion		506
Research As an Aid to Profits.....	H. Miller Lawder	509
Discussion		520

INVESTMENTS AND INVESTMENT BANKING

The Ratio Analysis of Securities.....	John Stevenson	523
Discussion		529
Analyzing Stocks and Bonds As Collateral Security		
Discussion	Fred J. McCauley	531
		535
The Investment Policy of Small Banks.....	Robert L. John	539
Discussion		543
The History and Future of Federal Land Bank Bonds		
Discussion	Wood Netherland	547
		554
The Future of Municipal Financing.....	Frank C. Nason	558
Discussion		563
The Investment Policy of Insurance Companies...	Clarence J. Daly	566
Farm Loans	A. C. Tosch	573
City Loans.....	Ivan D. Carson	577
Discussion		585
Judging the Relative Merits of Investment Trust Securities		
Discussion	Dr. A. D. H. Kaplan	589
		597

SAVINGS BANKING

The Human Equation in Savings Banking.....	Roy R. Marquardt	601
Discussion		609
Segregation of Funds.....	J. Howard Steensen	612
Discussion		617
New Business Development and Advertising.....	F. R. Kerman	619
Discussion		626
Unit System and Machines.....	H. R. Smith	636
Discussion		644
Uniform Method of Figuring Interest.....	Willard H. Dressler	648
Discussion		656
Insured Savings.....	Edward A. Richards	658
Discussion		662
Those Unprofitable Services.....	R. E. Chambers	666
Discussion		671
Savings and Loan Associations versus the Savings Bank		
Discussion	Ralph G. Holste	675
		678

Making Your Customer Feel Welcome.....	Dale M. Tussing	683
Discussion		689

TRUST FUNCTIONS

Some Practical and Legal Problems in Business Insurance Trusts	Raymond W. Hall	695
Discussion		704
Cooperation with Life Underwriters As They See It..	M. A. Linton	707
Discussion		717
Review and Analysis of Fee Schedules for Personal Trust Service in the United States.....	J. W. Garthwaite	721
Discussion		730
The Legal and Moral Responsibilities of a Corporate Trustee	William H. A. Johnson	734
Organization of the Probate Division.....	Phil D. Hall	739
Discussion		751
Legal Pitfalls in Accounting between Life Tenants and Remainder- men	Judge H. L. Standeven	755
Discussion		776
Effective Investment Management of Group Funds	Nelson M. McKernan	777
Discussion		786
Sales Arguments for Trust Prospects.....	A. B. Culbertson	789
Discussion		795
The Living Trust	Edward C. King	797
Discussion		810
Modern Facilities for the Systematic Review and Analysis of Trust Investments	Thomas J. Duffy	811
Discussion		819
Trust Department Development and Administration in City Branches	Andrew Wilson, Jr.	821
Trust Development and Administration in Statewide Branch Bank- ing Institutions.....	William W. Jacka	826
Discussion		833

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